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IN THE
Supreme Court of the United States

AMANDA ARMSTRONG; HUI MIN ZHAO; XIU ZHEN QI; MEN LIAN CHEN; EDWARD LIEBERMAN; JOHN DOES,
Petitioners,

v.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS; DEPARTMENT OF FINANCE,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Did the Ninth Circuit Court of Appeals err when it held that the Internal Revenue Code of the United States does not apply to the residents of the Commonwealth of the Northern Mariana Islands ("CNMI") as the territorial income tax and, consequently, no federal question jurisdiction exists for claims for relief alleging that local territorial legislation and territorial agency policies in the administration of the federally-authorized income tax rebate system, 48 U.S.C. § 1843, violate the Internal Revenue Code?

2. Did the Ninth Circuit Court of Appeals err when it held that Congress did not intend to apply to the CNMI the well-established exclusive federal district-court jurisdiction over all U.S. income tax matters arising from the local administration of the Guam Mirror Code system when Congress required that the income tax laws of the United States would apply to the CNMI "in the same manner as those laws are in force in Guam," Covenant § 601(a)?

3. Did the Ninth Circuit Court of Appeals err when it held that the CNMI legislature has the authority under the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America ("Covenant"), 48 U.S.C. § 1801, to require that all disputes arising under the administration of the CNMI Mirror Code income tax system must be brought exclusively in the CNMI Superior Court?

RULE 14.1(b) STATEMENT

The following were parties to the proceedings in the United States Court of Appeals for the Ninth Circuit:

1. Amanda Armstrong, Humin Zhao, Xiu Zhen Qi, Mei Lian Chen, and Edward Lieberman, Plaintiffs-Appellants, Petitioners on Review.
2. Commonwealth of the Northern Mariana Islands, Defendants-Appellees, Respondents on Review.

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

Amanda Armstrong *et al.* ("Plaintiffs") respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The Ninth Circuit had jurisdiction under 28 U.S.C. § 1291 and 48 U.S.C. § 1821(a). The Ninth Circuit affirmed the District Court's dismissal for lack of subject matter jurisdiction, holding that questions arising under the application of the income tax laws of the United States to the Commonwealth of the

Northern Mariana Islands ("CNMI") pursuant to Section 601 (a)-(c) of the "Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States," Pub. L. No. 94-241, 90 Stat. 263 (1976), *printed at* 48 U.S.C. § 1801 (note) ("Covenant"), do not involve questions of federal law under 28 U.S.C. § 1331.

Plaintiffs brought claims in the U.S. District Court for the CNMI, alleging that Plaintiffs and others similarly situated were injured when the CNMI government administered the CNMI Mirror Code income tax system contrary to the provisions of the Internal Revenue Code ("I.R.C.") and when the CNMI legislature adopted legislation modifying the formula set forth in the I.R.C. for calculating interest on income tax overpayments and refunds. The CNMI Mirror Code income tax system is substantively identical to the Mirror Code systems applicable in Guam and, prior to "de-linkage," in American Samoa. Plaintiffs' claims were initiated following an audit of the CNMI tax authority required by the U.S. Department of the Interior. The audit concluded that the CNMI failed to account for interest on $24 million of accrued rebates and refunds to which Plaintiffs and others similarly situated were entitled under the Internal Revenue Code and the U.S.-authorized rebate program.[1] Plaintiffs allege that the CNMI violated federal law when it refused to accrue interest on these late-paid rebates.

The Plaintiffs based their assertion of federal subject matter jurisdiction on Covenant Sections 601(a)-

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[1] *Auditor's Report of 2005 Northern Mariana Islands Government owes over $24 Million in Tax Rebates,* Tax Notes Int'l, August 28, 2006 (Doc. 2006-15927).

(c) that mandate the application of the I.R.C. as the local income tax law and on 48 U.S.C. § 1843(c) that amended CNMI's authority to rebate income taxes. In particular, the Plaintiffs alleged that the CNMI Department of Revenue and Tax violated federal law in its administration of the Mirror Code of the I.R.C. that is the territorial income tax code applicable to CNMI residents by:

> - The CNMI did not accrue interest pursuant to the I.R.C. applied locally as Northern Mariana Territorial Income Tax ("NMTIT") § 6611, providing for interest forty-five (45) days after the due date or filing of an income tax return with an overpayment;
>
> - The CNMI modified without federal consent the application of NMTIT § 6511 by the passage of a local law, 4 CMC § 1711(b).

The District Court dismissed Plaintiffs' complaint for lack of subject matter jurisdiction. (App. B, *infra*, 26a-28a.) The District Court reasoned that the authority that applies the income tax laws of the United States to CNMI residents as the full measure of the residents' United States income tax liability is not the United States, but the local CNMI legislature, which enacted the Northern Mariana Territorial Income Tax ("NMTIT") pursuant to Covenant §§ 601 (a)-(c). (*Id.*) Accordingly, the District Court concluded that exclusive jurisdiction over lawsuits challenging assessments, collections, or the wrongful retention of income taxes under the CNMI Mirror

Code is vested under the Covenant and by local legislation in the CNMI Superior Court.[2] (*Id.*)

The Ninth Circuit affirmed. *Armstrong v. Northern Mariana Islands*, 576 F.3d 950 (9th Cir. 2009). (App. D, *infra*, 31a-46a.) The Ninth Circuit reasoned that because the Covenant dictates that the I.R.C., then-existing and as Congress may amend it in the future, would apply to the residents of the CNMI as "a local territorial income tax," and because the CNMI legislature adopted the I.R.C. as CNMI law, the source of the authority for the income tax was the CNMI legislature, not federal law. *Id.* at 954-56. (App. D, *infra*, 38a-43a.) Accordingly, the Ninth Circuit concluded that claims arising under the CNMI mirror code were matters properly before the local courts and that were not subject to federal question jurisdiction. *Id.* (App. D, *infra*, 38a-43a.)

In addition to that holding, the Ninth Circuit also held that the direction in Covenant section 601(a) that the CNMI Mirror Code shall "come into force [in the CNMI]. . . in the same manner as those laws are in force in Guam" did not grant jurisdiction to the U.S. District Court of CNMI. *Id.* at 956-57. (App. D, *infra*, 43a-45a.) In reaching that holding, the Ninth Circuit distinguished prior precedents holding that

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[2] The District Court supplemented its conclusion by interpreting Plaintiffs' Complaint to allege violation of local laws adopted by the CNMI legislature to supplement or modify the authorized federal rebate program. (App. B, *infra*, 27a.) In this respect, the district court misread Plaintiffs' Complaint. Because the central thrust of Plaintiffs' claims is that "local" legislation and administrative actions violate the applicable federal law, the claims are based upon the latter. Under either view, the critical question is under what authority the IRC applies to the CNMI as the Mirror Code.

the U.S. District Court of Guam enjoyed jurisdiction over Guam Territorial Income Tax matters even when the Guam Organic Act was silent as to the jurisdiction of the Mirror Code. *Id.* (App. D, *infra*, 43a-46a.) *See, e.g., Laguana v. Ansell*, 102 F. Supp. 919 (D. Guam 1952), *aff'd by*, 212 F.2d 207 (9th Cir. 1954); *Holbrook v. Taitano*, 125 F. Supp. 14 (D. Guam 1954); *Wilson v. Kennedy*, 123 F. Supp. 156 (D. Guam 1954), *aff'd by*, 232 F.2d 153 (9th Cir. 1956). Moreover, ignoring that Guam's Mirror Code exclusive federal jurisdiction was well established at the time of negotiations of the Covenant and its ultimate approval, the Ninth Circuit reasoned that § 601(a) did not implicate the Guam judicial structure for enforcing the Mirror Code because: (1) the Mirror Code in Guam was applied by Congress through the Guam Organic Act, not the Covenant; (2) Congress used the term "local" in the Covenant but not in the Guam Organic Act; and (3) the CNMI legislature adopted legislation requiring all disputes under the CNMI Mirror Code to be brought in the local CNMI superior court. *Armstrong*, 576 F.3d at 956-58. (App. D, *infra*, 43a-45a.)

JURISDICTION

The Ninth Circuit's opinion was entered on August 7, 2009. The opinion was published. The Ninth Circuit granted a motion to extend time to file a motion for rehearing and *en banc* review on August 19, 2009. The Ninth Circuit denied a timely petition for rehearing *en banc* on October 16, 2009. The jurisdiction of the United States Supreme Court is invoked in a timely manner under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant provisions of the "Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States," Pub. L. No. 94-241, 90 Stat. 263 (1976) (printed at 48 U.S.C. § 1801 (note)); 48 USC § 1843; 26 U.S.C. §§ 6611, 6511; and 4 CMC §§ 1701, 1708, 1711, and 1715 are set forth at App. A, *infra*, 1a-25a.

STATEMENT OF THE CASE

This case raises questions of national importance concerning the uniformity of the administration and enforcement of United States income tax laws known as Mirror Code systems in U.S. territorial possessions, in particular in the Commonwealth of the Northern Mariana Islands (CNMI). In conflict with its own prior decisions and the decisions of sister courts, the Ninth Circuit Court of Appeals concluded no federal question is raised by the enforcement and application of the income tax laws of the United States as the territorial income tax in the CNMI and, thus, no federal subject-matter jurisdiction exists to resolve tax disputes involving such laws. That conclusion was error.

Congress enacted legislation imposing "Mirror Code" income tax systems in the U.S. Virgin Islands, Guam, the CNMI, and American Samoa. Under a Mirror Code system, the Internal Revenue Code – then-existing and as it may be amended in the future – is applied as the territorial income tax for the U.S. possession. The tax is administered by the revenue agency of the possession, which retains the tax proceeds. Local administration relieves the U.S. of the burden of compliance and assures a steady stream of financing for the local treasuries. These tax proceeds

retained by the possessions satisfy or defray U.S. financial support for the possession.[3]

Since the early 1970's, with the enactment of 26 U.S.C. § 935, the residents of Guam, including CNMI residents in 1978, file only one income tax return on their worldwide income (including U.S. income) with the local government. By application of federal law, CNMI residents and Guam residents are exempted from any other U.S. income tax return requirement. In its unprecedented holding in this case, the Ninth Circuit concluded that Congress intended by Covenant sections 601(a)-(c) to cede authority for the CNMI Mirror Code system to the local legislature and local courts. This holding forecloses federal-court review of such modifications and enforcement of the income tax laws of the United States as may be adopted by the local legislature or imposed by local agency discretion, notwithstanding that the CNMI Mirror Code system is the only federal income tax applicable to CNMI residents regardless of the geographic source and character of such residents' taxable income. Because the Ninth Circuit's decision conflicts with decades of jurisprudence and creates the first Mirror Code system in the United States that cedes jurisdiction to interpret and enforce federal income tax law to the local territorial legislature and courts, granting of this writ is imperative.

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[3] *Preece v. Comm'r*, 95 T.C. 594 (1990); *Bank of Guam v. United States*, 578 F.3d 1318 (Fed. Cir. 2009).

ARGUMENT

I. The Internal Revenue Code as it applies in the Northern Mariana Islands as the Northern Mariana Territorial Income Tax (NMTIT) is federal law.

Covenant sections 601 (a)-(c) mandate application of the Mirror Code system to the CNMI:

> Covenant Section 601.
>
> a) The income tax laws in force in the United States will come into force in the Northern Mariana Islands as a local territorial income tax on the first day of January following the effective date of this Section, in the same manner as those laws are in force in Guam.
>
> (b) Any individual who is a citizen or a resident of the United States, of Guam, or of the Northern Mariana Islands (including a national of the United States who is not a citizen), will file only one income tax return with respect to his income, in a manner similar to the provisions of Section 935 of Title 26, United States Code.
>
> (c) References in the Internal Revenue Code to Guam will be deemed also to refer to the Northern Mariana Islands, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof or of this Covenant.

See 48 U.S.C. § 1801 (note). (App. A, *infra*, 1a-2a.)

By operation of Covenant Section 601(a), the Internal Revenue Code became the local territorial income tax for all residents of the CNMI on its effective date

on January 1, 1978.[4] At the time of the Covenant negotiations, both the representatives of the people of the Northern Mariana Islands and the United States extensively discussed the application of the Internal Revenue Code as the territorial income tax. In its report on the Covenant, the Marianas Political Status Commission expressly stated that "[u]nder Subsection (a) the federal income tax laws will apply as a local territorial income tax in the same manners as those laws are enforced in Guam." *See* Marianas Political Status Commission, *Section by Section Analysis of the Covenant*, at 67, 68 (1975). (App. F, *infra*, 47a-55a.)[5] The Marianas Political Status Commission prepared this report on the Covenant for the people of the Northern Mariana Islands before the islands-wide vote. *Id.* at 1. (App. F, *infra*, at 47a.) By the time the people of the Northern Mariana Islands voted for the Covenant, the Guam Mirror Code system had been in place for thirty years.

The CNMI resisted adoption of the Internal Revenue Code as the territorial income tax, and numerous delays were requested from Congress. *See* Pub. L. No. 96-205, Title II, § 205, 94 Stat. 87 (1980); Pub. L. No. 96-597, Title III, § 303(a), 94 Stat. 3478 (1980); Pub. L. No. 98-213, § 3(a), (b), 97 Stat. 1459 (1983) (codified at 48 U.S.C. § 1843). Each of these laws

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[4] *Presidential Proclamation* 4535, 42 Fed. Reg. 56593 (1977) (effective date of Covenant Section 601 is January 9, 1978).

[5] Reprinted in *Hearings on the Covenant to Establish the Commonwealth of the Northern Mariana Islands before the Subcommittee on Territorial and Insular Affairs of the House Committee on Interior and Insular Affairs*, 94th Cong., 1st Sess. 626 (1975), and in *Hearings on the Northern Mariana Islands before the Senate Committee on Interior and Insular Affairs*, 94th Cong., 1st Sess. 356 (1975).

postponed the effective date of the Internal Revenue Code as the NMTIT, ultimately delaying its implementation to January 1, 1985. None of these laws, however, changed the source of the authority that applies this Mirror Code—the U.S. Congress.

The federal tax policy behind the Mirror Code is twofold: (1) to establish revenue for the government of the possession and thereby to fulfill in part Congress's financial obligation to fund or provide for such government operations; and (2) to place the administrative burden of administering the income tax upon the possession.[6] In 1983, Congress wrote a historical report on the CNMI issues surrounding the application of the income tax laws of the United States as a mirror code.[7] In this report, Congress specifically addressed how the CNMI income tax system as a mirror of the Internal Revenue Code should result in identical income taxes imposed under the federal system.[8] The best judicial overview

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[6] Covenant Section 703 provides for the transfer of all income tax revenues to the CNMI treasury. *See also* 48 U.S.C. §1842 (covering proceeds under Covenant Section 601 to the CNMI Treasury).

[7] "The erroneous notion that the government of the Northern Mariana Islands (NMI) should establish and administer its own income tax code is not new. Even after this concept's rejection in negotiating rounds leading to the f[sic framing] of the Covenant still persists." *Intent of the Law under Section 601 and 602 the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America*, 129 Cong. Rec. H. 7861, 7862 (Oct. 3, 1983) (remarks of Rep. Won Pat). For a detailed history of the application of the mirror code problems in the CNMI, *see* Senate Report at 98-46.

[8] "Under the Covenant which established the Commonwealth of the Northern Mariana Islands as the newest member of the American Political family (P.L. 94-241), the so-called mirror

of the CNMI Mirror Code system is the U.S. Tax Court decision in *Preece v. Comm'r*, 95 T.C. 594 (1990). In *Preece,* the U.S. Tax Court held that in accordance with I.R.C. § 935, as adopted by Covenant Section 601(b), the CNMI Mirror Code is federal law, not local law. *Preece*, 95 T.C. at 595. By Covenant Section 601(a), the Internal Revenue Code became the local territorial income tax for all residents of the CNMI on its effective date.[9]

Under I.R.C. § 935, a taxpayer who is a resident of Guam or the CNMI files one return with the local possession for all U.S. income taxes owed by the resident on that resident's world-wide income.[10] Congress created I.R.C. § 935 to eliminate the burdens associated with the filing of two income tax returns—one with Guam and one with the U.S. Government.

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system of taxation applies to the territory in the same way that it does to Guam. Residents are to pay a tax identical to that imposed by the Internal Revenue Code to the territorial government. Taxes received by the territory may be rebated except that rebates are limited to taxes on Northern Mariana Island sourced Income." H.R. No. 98-174, Pub. L. No. 98-213, 97 Stat. 1459 (1983).

[9] Covenant Section 601(a) provides that "[t]he income tax laws in force in the United States will come into force in the Northern Mariana Islands as a local territorial income tax on the first day of January following the effective date of the Section, in the same manner as those laws are in force in Guam." *See* 48 U.S.C. § 1801 (note). (App. A, *infra*, 1a-2a.)

[10] Section 935 was subsequently repealed by section 1272(d)(2) of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2594 (1986), for taxable years beginning after December 31, 1986. This was held in abeyance by virtue of the fact that the CNMI has not "de-linked" from the Mirror Code. *See* Tax Reform Act of 1986, § 1271, Pub. L. No. 99-514, 100 Stat. 2594 (1986). CNMI and Guam are subject to the Internal Revenue Code in existence before the Tax Reform Act of 1986. *See* T.D. 9143 (2005).

This system is called the "single return rule." As *Preece* court explained:

> In sum, section 935 required the filing of a single return and the payment of tax on income from all sources with either the United States or Guam depending upon the residency of the taxpayer if there was a residency in either jurisdiction. *See* H. Report 92-1479, 1972-2 C.B. 760. . . . Section 601(b) of the Covenant expressly adopted the single filing system of section 935 for use in the CNMI. Thus, the citizens of the United States residing in the CNMI would be relieved of the liability of filing income tax returns in the United States and instead would file income tax returns with the CNMI.

Preece, 95 T.C. at 600.

While the Ninth Circuit in this case struggled with "local" application of the CNMI Mirror Code system, the U.S. Tax Court in interpreting Covenant Section 601 relied on longstanding congressional and judicial precedents regarding the application of the Mirror Code system in Guam. The Ninth Circuit's conclusion that the CNMI's adoption of the income tax laws of the United States is merely local law, not federal law, ignores prior decisions holding that Covenant Section 601(b) mandates the "single return rule" for tax on all sources of income. With the present Ninth Circuit's panel decision, the U.S. tax liability of CNMI residents for their world-wide income will now be only a local issue.

II. The Ninth Circuit's panel decision conflicts with its own precedents on the application of the CNMI income tax laws pursuant to Covenant Section 601.

In *Holmes v. Dir. of Revenue & Taxation*, 827 F.2d 1243 (9th Cir. 1987), the Ninth Circuit considered the Government of Guam's denial of a subchapter S election of a CNMI corporation by Guamanian residents. The Government of Guam took the position that, through a strict reading of the Mirror Code using the substitution scheme, CNMI corporations would be treated as foreign corporations and, thus, ineligible for this election. In *Holmes*, the Ninth Circuit considered the application and language of Covenant sections 601(a) and (c) that indisputably mandate a Mirror Code system for the CNMI. "Under 48 U.S.C. § 1421i(e) and I.R.C. § 935(c)(2), the so-called 'mirroring provisions,' we must substitute 'Guam' for the 'United States' in applying the definition; and section 601(c) of the Covenant requires us to include the CNMI within the term 'Guam.'" *Id.* at 1245. Thus, in *Holmes*, the Ninth Circuit treated the CNMI and Guam as a common geographic entity for application of the Guam Mirror Code provisions of the I.R.C.[11] Under the Ninth Circuit's decision in this case, however, the federal courts would be precluded from reviewing the corollary conduct by the CNMI Department of Revenue and Taxation in its application of the Mirror Code to a Guam corporation. By virtue of this Ninth Circuit's decision, a federal court

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[11] In *Holmes*, the Ninth Circuit accepted the intent of the Covenant negotiators that "[i]t is desirable that Guam and the Northern Mariana Islands have coordinated tax laws since they operate in the same economic and geographic sphere." *See Marianas Political Status Commission, Supra* Note 5 at 68.

cannot review the application of the Mirror Code provision if the Commonwealth's mirror code is a local law, making the holding in *Holmes* wholly inapplicable to the CNMI.

III. The Ninth Circuit's opinion also conflicts with its prior precedents holding that the federal courts have jurisdiction over matters arising out of the administration and enforcement of the Guam Mirror Code without a specific grant from Congress.

From 1952 through 1958, the Ninth Circuit and its lower courts repeatedly concluded that, although no statute expressly granted jurisdiction to the federal courts to enforce the Mirror Code in Guam, the laws that apply the I.R.C. as the territorial income tax in Guam were inherently federal and, thus, provided subject matter jurisdiction in the district courts over disputes over the application and enforcement of Mirror Code provisions. *See, e.g., Laguana v. Ansell*, 102 F. Supp. 919 (D. Guam 1952), *aff'd by*, 212 F.2d 207 (9th Cir. 1954); *Holbrook v. Taitano*, 125 F. Supp. 14 (D. Guam 1954); *Wilson v. Kennedy*, 123 F. Supp. 156 (D. Guam 1954), *aff'd by*, 232 F.2d 153 (9th Cir. 1956); *Jennings v. United States*, 168 F. Supp. 781 (Fed. Ct. Cl. 1958).

The district court in *Wilson*, in a decision affirmed by its Court of Appeals, offered the following probative analysis on the adoption of the I.R.C. as the Guam Territorial Income Tax ("GTIT"):

> In the first place, we must distinguish between Section 31 [of the Guam Organic Act], which makes the income tax laws in force in the United States of America, current and future, in force in

> Guam, and any authority the Guam Legislature may have to legislate in the field. The United States Congress as the parent legislative body made the "income tax laws" applicable. We are dealing with a law of the United States. In this complex field, it would appear that Congress intended to more than just levy taxes. It intended that the income tax laws in the United States should govern the taxpayer on Guam at any given time. Like the taxes themselves, enforcement of collection must necessarily vary or change at the will of the Congress.

Wilson, 123 F. Supp. at 159 (emphasis added); *see also Jennings*, 168 F. Supp. at 784 ("[t]he Federal income tax laws enacted by Congress and in force in the United States and did not create a separate territorial income tax law in the sense that the Government of Guam was the taxing authority or the legislative authority for such tax.").

The Ninth Circuit's opinion in this case not only minimizes the references to the Guam Mirror Code system in the CNMI Covenant and the history of its negotations, but also minimizes the federal case law that consistently shaped the Mirror Code systems. According to the Ninth Circuit panel decision in this case, by merely calling the territorial income tax in the Commonwealth "local," all vestiges of federal court jurisdiction are lost. The Ninth Circuit distinguished the CNMI experience from Guam based upon the different statues that implemented the same Mirror Code system in each respective jurisdiction: for the CNMI, it is the Covenant, and for Guam, it is an Organic Act. Contrary to the Ninth Circuit's conclusion, however, the Mirror Code systems are the same, and both are inherently federal.

IV. The Ninth Circuit's decision holding the CNMI Mirror Code to be adopted under the authority of the local possession conflicts with decisions from the Third and Federal Circuits, holding that federal law is the source of authority for the Mirror Code systems.

It has been over eighty years since the Mirror Code system was first introduced by Congress in the Virgin Islands.[12] Decisions of the Third Circuit Court of Appeals find no ambiguity as to whether matters arising under the Virgin Islands territorial income tax are matters of federal law supporting federal question subject matter jurisdiction in the district court of the possession. "Beyond merely extending the geographic coverage of the Internal Revenue Code, this statute [48 U.S.C. § 1397] in effect creates a separate territorial income tax measured by that Code and to be collected by the Government of the Virgin Islands." *Chi. Bridge & Iron Co. v. Wheatley*, 430 F.2d 973, 975 (3d Cir. 1970) (relying on the Ninth Circuit cases); *HMW Indus., Inc. v. Wheatley*, 504 F.2d 146, 150 (3d Cir. 1974) (Congress created a separate tax structure for the Virgin Islands mirroring the provisions of the federal tax code except as to those provisions which are incompatible with such a separate tax structure.); *Vitco, Inc v. Gov't of the Virgin Is.*, 560 F.2d 180, 185 (3d Cir. 1977) (substantive equality of the treatment of a U.S. resident taxpayer and a Virgin Islands citizen-taxpayer is the goal of the mirror system); *Chase Manhattan Bank v.*

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[12] The "U.S. Virgin Islands in Naval Appropriations Act of July 12, 1921," Pub. L. No. 67-35, 42 Stat. 123 (1921) (*codified as amended* at 48 U.S.C. § 1397), mandates the income tax laws of the United States as the territorial income tax.

Gov't of the Virgin Is., 300 F.3d 320, 325 (3d Cir. 2002) (Virgin Islands' local legislature cannot change the interest rate set by the I.R.C.).

In the Federal Circuit, the recent decision of *Bank of Guam v. United States*, 578 F.3d 1318 (Fed. Cir. 2009), considered the application of the income tax laws of the United States as they apply to Guam as the local territorial income tax. The Federal Circuit concluded that Guam administers the income tax laws of the United States at the direction of the United States and not the possession or territory. *Id.* at 1327-28, 1328, n.5. The Federal Circuit considered and rejected the Bank of Guam's argument that the Guam tax system was purely local since the Guam legislature had the option to "delink" from the Mirror Code system pursuant to Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986) ("Tax Reform Act of 1986"). *Id.* The mere fact that Guam could delink from the application of the Mirror Code system did not destroy the inherently federal nature of the Mirror Code. *Id.* The Federal Circuit held that, as Guam is only administering the federal law, Guam as the U.S. income tax code's administrator had the right to tax the Bank's U.S. bonds, just as the United States government is permitted to tax U.S. bonds. *See id.* at 1326-29. Moreover, the express exclusion from local state and possession tax of U.S. bonds was inapplicable because the imposed income tax was federal, and Guam was merely standing in the place of the United States as a recipient of the tax proceeds permitted to the federal government on U.S. bonds. *Id.*

Through precedents and review of congressional history, norms of interpretation and interaction of the Mirror Code system have evolved that apply

equally to the CNMI, Guam, and the Virgin Islands.[13] While the Ninth Circuit panel decision in this case distinguished the CNMI from the general norms of interpretation of the Mirror Code system because of an alleged distinct nature of the relationship between the CNMI and the United States attributed to the Covenant, the terms of the Covenant itself reject that distinction. The Covenant is in force as a statute of the United States for income tax matters and under no unique limitation as is found certain other provisions of the Covenant authority.[14] Covenant section 101 provides that the CNMI is placed under the sovereignty of the United States.[15]

With respect to issues of taxation, Covenant section 105 affirms U.S. sovereignty, consistent with section 601's direction that the U.S. Mirror Code system will apply as the territorial income tax.[16] There is no basis to distinguish the authority from which the Mirror Code applies to Guam and the CNMI.

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[13] *See generally*, Mary Kay Dunning, *Equality Principle for the Virgin Islands Tax Clarified by the Third Circuit: Chase Manhattan Bank v. Government of the Virgin Islands*, 56 Tax Law 665, 670 (Spring 2003); Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, H.R. 3838, Pub. L. No. 99-514, 100 Stat. 285 (May 4, 1987), 1115-23.

[14] *Supra* note 5; *see also United States v. De Leon Guerrero*, 4 F.3d 749 (9th Cir. 1993).

[15] *CNMI v. United States*, 399 F.3d 1057 (9th Cir. 2005). Article I provides that the Covenant, "together with those provisions of the Constitution, treaties, and laws of the United States applicable to the Northern Mariana Islands, will be the supreme law of the Northern Mariana Islands." *Id.* § 102. Article I also establishes that the United States has "complete responsibility for and authority with respect to matters relating to foreign affairs and defense." *Id.* § 104.

[16] *Supra* footnote 5.

V. Covenant Section 601's directive that the Mirror Code system in the CNMI will be "in force" in the "same manner as Guam" extends subject matter jurisdiction to the CNMI district court.

As cited previously, the Congress extensively reviewed the application of the I.R.C. to the CNMI.[17] Before the CNMI people approved the Covenant, the Marianas Political Status Commission explained the income tax system.

> "Under Subsection (a) the federal income tax laws will apply as a local territorial income tax in the same manners as those laws are enforced in Guam. This system is a sound one and it apparently works well in Guam. Certain problems which had plagued the operation of the federal tax law as a local tax law—called the "mirror image system"—in Guam have now been resolved. It is desirable that Guam and the Northern Mariana Islands have coordinated tax laws since they operate in the same economic and geographic sphere."

See supra, fn. 5 at 68. When the CNMI had difficult complying with the express terms of Covenant Section 601, Congress in 1983 prepared a special report on the CNMI income tax system to clear up any misunderstandings. *Id.*

In addition to this extensive legislative history, the Federal Commission on the Application of Federal Laws to the Northern Mariana Islands[18] also con-

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[17] *Id.*

[18] Federal Commission on the Application of Federal Laws to the Northern Marianas Islands was a commissioned formed pursuant to Covenant Section 504.

curred with the analysis that the phrase "same as Guam" included the federal court jurisdiction over CNMI income tax matters. The Federal Commission opined that the Guam Organic Act's enforcement and jurisdiction provisions mirroring the I.R.C. provisions known as the Guam Territorial Income Tax (GTIT) were incorporated by reference: "District Court for the Northern Mariana Islands has civil and criminal jurisdiction over disputes involving the local territorial income taxes of the Northern Mariana Islands."[19] Lastly, the U.S. Tax Court in the *Preece* clearly employed the analysis as what Covenant Section 601 meant by the phrase "same as Guam." *Preece*, 95 T.C. at 959.

The Ninth Circuit in this case refused to encompass the jurisdictional element of the application of the income tax laws in Guam to the CNMI based upon the Covenant Section 601. *See Armstrong*, 576 F.3d at 956-58. (citing 48 U.S.C. § 1421i(g),(h)). (App. D, *infra*, 43a-45a.) There is strong support for federal court jurisdiction in matters arising under the CNMI mirror code system in the Legislative history that the Ninth Circuit ignored. Exclusive federal court jurisdiction to enforce and supervise the local administration of the Guam territorial income tax law was well-established when Congress negotiated and approved the Covenant in the mid-1970's and is confirmed in the legislative history noted above. Instead of following this clear authority, the panel reasoned that because Congress mandated the Mirror Code to the CNMI through the Covenant while

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[19] *Welcoming America's Newest Commonwealth-The Second Interim Report of the Northern Mariana Islands Commission on Federal Laws to the Congress of the United States,* at 436 (August 1985).

applying the same law to Guam through an Organic Act, and because the CNMI Mirror code was referred to a "local" territorial income tax, the "in force" clause could not include federal court jurisdiction. That error frustrates clear Congressional intent to secure federal court review of the application of the U.S. tax laws throughout all possessions.

VI. Ninth Circuit panel misquoted the District Court in another case that arose under 48 USC § 1843(c)

The Ninth Circuit's decision also ignored the fact that only federal law can and does authorize the Commonwealth's rebate of income taxes and that Plaintiffs' claims for relief expressly assert violations of these federal laws. *See* 48 USC § 1843 (amending Covenant Section 602). The Ninth Circuit concluded that, since Congress permitted the CNMI to set the rebate rate, the whole rebate system was local law and wholly within the jurisdiction of local courts.[20] That holding not only conflicts directly with the decision in *Olopai v. De Leon Guerrero*, 1993 U.S. Dist. LEXIS 13839 (D. N. Mar. I. Sept. 24, 1993), and 48 U.S.C § 1843,[21] but also with congressional intent expressed at the time of passage of 48 U.S.C. § 1843.

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[20] "Despite the Public Law 96-205 expression of the sense of Congress that the territory's authority to rebate taxes received by it does not permit abatement of tax liability and plain and clear expressions by members of the Committee that it must collect the mirror code taxes, the Northern Mariana Islands is not now requiring payment." *Supra* Note 8, at 2213.

[21] Pursuant to 48 U.S.C. § 1843, taxes rebated by the CNMI cannot exceed taxes actually paid for any tax year and rebates can only be made following the close of the tax year involved. Further, the CNMI is required to maintain as a matter of public

The Ninth Circuit misquotes *Olopai*, 1993 U.S. Dist. LEXIS 13839 (D. N. Mar. I. Sept. 24, 1993). In that case the court rejected the same argument advanced by the CNMI in this case, *i.e.*, that Covenant Article IV stripped the federal court of jurisdiction over income tax matters arising under the NMTIT.[22] Specifically, the court stated:

> The Governor contends that the procedures concerning the rebate of taxes are a matter of local law by virtue of the Covenant Section 602, which provides that: "The Government of the Northern Mariana Islands may by local law provide for the rebate of any taxes received by it" . . . the Governor raised a similar argument first before this Court and then the Ninth Circuit in the Inspector General Case . . . the Ninth Circuit, citing the Covenant § 101 which provides that the CNMI is under the sovereignty of the United States and Section 102 which makes the Covenant and all applicable federal laws the supreme law of the CNMI, rejected the Governor's broad interpretation as "untenable."

Olopai at *10.

The Ninth Circuit's holding also cannot be reconciled with 48 U.S.C § 1843. If Congress extensively legislated the CNMI rebate system with 48 U.S.C. § 1843, then it begs the question how can the administration enforcement be possible if the whole

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record the identity of each rebate recipient and the amount of the rebate.

[22] *See also supra* Note 7, where in 1983, Congress reviews the exact same argument and expressly rejects it. *See also* 48 USC § 1841(d).

rebate system is local and not subject to federal review as this Ninth Circuit found.

Again, the legislative history surrounding 48 U.S.C.§ 1843 demonstrates that, contrary the Ninth Circuit's conclusion that implementation of the Internal Revenue Code required the local CNMI legislature to pass the Internal Revenue Code, Congress intended Covenant section 601 to require immediate implementation by the CNMI.[23] There is neither a statutory nor a historical basis for the Ninth Circuit's different treatment of the federally-authorized CNMI rebate system and the locally-enacted rebate law of Guam. *See* Covenant Section 602, *as amended by* 48 U.S.C. § 1843. That is especially true when the Guam rebate system was locally enacted, and the Ninth Circuit found that it had jurisdiction over all rebate tax matters. *See Ramsey v. Chaco*, 549 F.2d 1335 (9th Cir. 1977) (congressional inaction to strike the local rebate law, Guam rebate law upheld; *Gov't of Guam v. Superior Ct. of Guam*, 998 F.2d 754 (9th Cir. 1993) (federal jurisdiction over Guam rebate law even though the law was created by the local legislature).

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[23] "The Committee is of the unalterable opinion that the Northern Mariana Islands should be implementing the mirror income tax code to the letter of the Covenant and in the spirit with which the Covenant was negotiated, unless a new understanding is reached between the United States and the Commonwealth. Forthright implementation of the mirror income tax code, the committee notes, is integral to all aspects of the relationship established between the Commonwealth and the United States." *See supra* Note 8, at 2213. Pursuant to 48 USC § 1841(d). this provision permits with the CNMI permission that the IRS come in administer the IRC as the local law and provide tax assistance for free to the CNMI government.

VII. Congress enacted a statute to create a wholly local income tax system at the election of the CNMI with specific federal guidance and conditions.

Finally, the Ninth Circuit did not give proper consideration to the Tax Reform Act of 1986, the statute that Congress provided for the CNMI to delink from the Mirror Code. By enacting the Tax Reform Act of 1986, Congress ceded to the numerous complaints from the Mirror Code possessions (that is, Guam, American Samoa, CNMI) regarding the application of federal income tax laws as the territorial tax.[24] The Act permitted Guam, CNMI, and American Samoa to "delink" from the Mirror Code system. By delinking from the Mirror Code, these governments could create local tax laws that were more suitable to their areas. Congress would only permit the possessions to delink if the local governments went through a step by step process as outlined in the Tax Reform Act.[25] Moreover, if the possession "delinks," the single return rule under IRC Section 935 expires and CNMI residents would have a dual income tax return requirement consistent with the terms in IRC Section 931. This dual return filing requirement would require payment to the local treasury for locally-sourced income and payment to the U.S. Treasury for U.S.-sourced income. The CNMI never accepted "delinkage."

The Ninth Circuit's opinion permits the CNMI to have a wholly local tax system not subject to federal

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[24] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (H.R. 3838, Pub. L. No. 99-514, 100 Stat. 285 (May 4, 1987), at 1115-23.

[25] *Supra* Note 13, at 1121.

review without going through the process that Congress requires for Mirror Code possessions to delink. Consequently, CNMI taxpayers are not required to file any federal income tax return with U.S. Treasury, and there is now no federal court jurisdiction to assure compliance with federal income tax laws. The Ninth Circuit's reasoning that the "delinkage" statute does not support federal jurisdiction ignores how I.R.C. § 935 works in possessions following the single return rule and how this single return rule is an implicit and integral part of the Mirror Code system.

VIII. The Ninth Circuit's decision in this case creates an unintended tax haven.

In the present matter, the Ninth Circuit decision coupled with established federal law will lead to the creation of a U.S. tax haven, contrary to Congress's clear intent. [26] As the CNMI government normally rebates up to 90% of the federal income tax rate and with this decision could protect taxpayers from the jurisdictional reach of the United States.[27] By operation of this decision, there is no federal court jurisdic-

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[26] ". . . But the Committee also recognizes the compelling deficiencies of substituting locally-determined tax codes for the rate effective nationally, mirrored to territorial circumstances. These deficiencies include the inequities and inadvisable competition which would result from disparities between tax rates of neighboring territories and the inherent uncertainty of local tax code determinations among others." *Supra* Note 8 at 2213.

[27] 4 CMC § 1708 (local law setting rebate rate). Petitioners cannot help but to note the irony of their position where the CNMI has failed to pay out the rebates and the allegation that the Ninth Circuit's decision would lead to a creation of a tax haven. However, with such a significant federal court decision there would be new economic activity that would encourage U.S. taxpayers seeking relief from U.S. tax rates to consider the CNMI as place to shelter income.

tion for matters arising under NMTIT as it applies the I.R.C. in income tax matters, eliminating generally federal review of CNMI income tax matters. Secondly, the single return rule, I.R.C. § 935, blocks the IRS from requiring any income tax return requirement of CNMI residents absent the IRS's allegation of fraud as to Bona Fide Residency under I.R.C. § 937. Thirdly, the Ninth Circuit affirms that a matter arising under the administration of the CNMI rebate system—which permits the CNMI government to set the rebate rate of income taxes—is wholly a local matter not subject to federal court review at all. Lastly, the Ninth Circuit implicitly affirmed that the CNMI legislature can modify terms of the I.R.C. as it applies in the CNMI, giving the CNMI unprecedented power to make substantive change to the I.R.C. to advantage CNMI taxpayers.[28]

In the present decision, the Ninth Circuit's decision permits the CNMI to alter the date of when interest accrues on an overpayment of income tax—that date is set by the I.R.C. and applies to the CNMI through NMTIT (I.R.C.) § 6611 and NMTIT (I.R.C.) § 6511. Nevertheless, the CNMI legislature passed 4 CMC § 1711(b), which attempted to alter the date that interest would accrue from the federally-required 45 days after the due date of the income tax return to six months.[29] Petitioners sought a declaration that this CNMI law violates the federal statute and that

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[28] This is completely different authority from Government of Guam's system.

[29] NMTIT § 6511 states interest will accrue 45 days after the due date or the date of filing the return whichever is later. 4 CMC § 1711(b) states interest does not accrue until after six (6) months from the due date or the date of filing whichever is later.

rebates are overpayments within the meaning of I.R.C. § 6611 (N.M.T.I.T. § 6611) subject to interest imposed under federal law. By denying all federal jurisdiction to review this amendment, the Ninth Circuit's decision conflicts with *Bank of America v. Chaco,* 539 F.2d 1226 (9th Cir. 1976) (only Congress can make substantive changes to Mirror Code in Guam), and *Chase Manhattan Bank,* 300 F.3d 320 (Virgin Islands cannot change interest rate under Mirror Code by local law); *Chi. Bridge & Iron Co.*, 430 F.2d 973 (Virgin Island legislature cannot modify definition of "domestic" found in Mirror Code). Moreover, the Ninth Circuit decision ignores the general principles espoused by the United States Supreme Court in *Limtiaco v. Camacho*, 549 U.S. 483, 489 n.2 (2007) (Guam Territorial legislature cannot redefine the terms used in a federal statute).

The Ninth Circuit decision so conflicts with not only significant federal court precedent that the local territories cannot change the application of Federal law because it is inconvenient or difficult to comply with but also the policy of uniformity of tax administration. No federal court should permit the CNMI legislature to alter, amend, or change a mandated federal law pursuant to Covenant Sections 601 and 602, as amended by 48 U.S.C. § 1843. *See* Covenant § 105 (printed at 48 U.S.C. § 1801 (note)).[30]

At footnote 6 where the Ninth Circuit discusses that there may be times that the federal court has jurisdiction in CNMI income tax matters where there is a significant federal interest. *See* App. In those instances, the Ninth Circuit opined that by application of the Substantial Federal Question doctrine

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[30] *Supra*, note 7 at 7861.

jurisdiction would be appropriate. Imposing the Substantial Federal Question doctrine will needlessly spur constant litigation and disturb the established federal agency precedent of the IRS in the administration of federal tax policy in the U.S. Possessions and in the CNMI. There is no doubt that taxpayers and the CNMI government will challenge the federal government's interest in their income tax program by virtue of this Ninth Circuit decision. In particular, the taxpayers will have substantial justification for aggressive income tax return positions where normally these suspect positions would not have any colorable law to rely upon.

CONCLUSION

For the above reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A

48 U.S.C. § 1801

§ 1801. Approval of Covenant to Establish Commonwealth of Northern Mariana Islands

That the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America, the text of which is as follows [note to this section], is hereby approved.

1. Explanatory notes:

This section formerly appeared as 48 U.S.C. § 1681 note.

2. Other provisions:

* * * * *

Covenant to Establish Commonwealth of the Northern Mariana Islands in Political Union with the United States of America. Act March 24, 1976, P.L. 94-241, 90 Stat. 263; Dec. 8, 1983, P.L. 98-213, § 9, 97 Stat. 1461; Aug. 27, 1986, P.L. 99-396, § 10, 100 Stat. 840; Sept. 30, 1996, P.L. 104-208, Div A, Title I, § 101(d) [Title I], 110 Stat. 3009-196; May 8, 2008, P.L. 110-229, Title VII, Subtitle A, § 702(g)(1), 122 Stat. 864, provides:

* * * * *

" 'Article VI

" 'Revenue and Taxation

" 'Section 601. (a) The income tax laws in force in the United States will come into force in the Northern Mariana Islands as a local territorial income tax on the first day of January following the effective date of this Section [See Sec. 1003 of this note], in the same manner as those laws are in force in Guam.

" '(b) Any individual who is a citizen or a resident of the United States, of Guam, or of the Northern Mariana Islands (including a national of the United States who is not a citizen), will file only one income tax return with respect to his income, in a manner similar to the provisions of Section 935 of Title 26, United States Code.

" '(c) References in the Internal Revenue Code to Guam will be deemed also to refer to the Northern Mariana Islands, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof or of this Covenant.

" 'Section 602. The Government of the Northern Mariana Islands may by local law impose such taxes, in addition to those imposed under Section 601, as it deems appropriate and provide for the rebate of any taxes received by it, except that the power of the Government of the Northern Mariana Islands to rebate collections of the local territorial income tax received by it will be limited to taxes on income derived from sources within the Northern Mariana Islands.

48 U.S.C. § 1843

§ 1843. Tax exemptions for individuals and entities

(a) Taxable years beginning after December 31, 1978, but not after January 1, 1985. Except as provided in subsection (c), any person, including an individual, trust, estate, partnership, association, company, or corporation, which is a resident of or which is organized under the laws of the Commonwealth of the Northern Mariana Islands and which is subject to the provisions of section 601 of the Covenant to Establish the Commonwealth of the Northern Mariana Islands in Political Union with the United States (Public Law 94-241) [48 U.S.C. § 1801 note], shall be exempted from the requirements of such section with respect to income derived from sources within the Commonwealth of the Northern Mariana Islands for taxable years beginning after December 31, 1978, until, but not after, January 1, 1985. Nothing in this section shall be construed as relieving such person from the obligation to comply with the requirements of section 601 [48 U.S.C. § 1801 note] with respect to income derived from sources outside of the Commonwealth of the Northern Mariana Islands.

(b) Taxable years beginning after December 31, 1980, and before January 1, 1982. Except as provided in subsection (c), any person, including an individual, trust, estate, partnership, association, company, or corporation, which is a resident of or which is organized under the laws of the Commonwealth of the Northern Mariana Islands and which is subject to

the provisions of section 601 of the Covenant to Establish the Commonwealth of the Northern Mariana Islands (Public Law 94-241) [48 U.S.C. § 1801 note], shall be exempt from the requirements of such section with respect to income from sources within the Northern Mariana Islands for its taxable year beginning after December 31, 1980, and before January 1, 1982: *Provided,* That the Secretary receives written notice from the Governor of the Northern Mariana Islands not later than September 30, 1980, that sections 1, 2, 3, 4, and 5 of chapter 2 of Public Law 1-30 of the Commonwealth of the Northern Mariana Islands [unclassified] or its successor, have been repealed in their entirety, effective December 31, 1981.

(c) Tax rebates. As provided in section 602 of Public Law 94-241 (90 Stat. 263, 270) [48 U.S.C. § 1801 note] the term "rebate of any taxes" shall, effective January 1, 1985, apply only to the extent taxes have actually been paid pursuant to section 601 of said Act [48 U.S.C. § 1801 note], shall not exceed the amount of tax actually paid for any tax year, and may only be paid following the close of the tax year involved. Notwithstanding any other provision of law, effective January 1, 1985, the Commonwealth of the Northern Mariana Islands shall maintain, as a matter of public record, the name and address of each person receiving such a rebate, together with the amount of the rebate, and the year for which such rebate was made.

26 U.S.C. § 6611

§ 6611. Interest on overpayments.

(a) Rate. Interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the overpayment rate established under section 6621 [26 U.S.C. § 6621].

(b) Period. Such interest shall be allowed and paid as follows:

(1) Credits. In the case of a credit, from the date of the overpayment to the due date of the amount against which the credit is taken.

(2) Refunds. In the case of a refund, from the date of the overpayment to a date (to be determined by the Secretary) preceding the date of the refund check by not more than 30 days, whether or not such refund check is accepted by the taxpayer after tender of such check to the taxpayer. The acceptance of such check shall be without prejudice to any right of the taxpayer to claim any additional overpayment and interest thereon.

(3) Late returns. Notwithstanding paragraph (1) or (2) in the case of a return of tax which is filed after the last date prescribed for filing such return (determined with regard to extensions), no interest shall be allowed or paid for any day before the date on which the return is filed.

(c) Repealed.

(d) Advance payment of tax, payment of estimated tax, and credit for income tax withholding. The provisions of section 6513 [26 U.S.C. § 6513] (except the provisions of subsection (c) thereof), applicable in determining the date of payment of tax for purposes of determining the period of limitation on credit or refund, shall be applicable in determining the date of payment for purposes of subsection (a).

(e) Disallowance of interest on certain overpayments.

(1) Refunds within 45 days after return is filed. If any overpayment of tax imposed by this title is refunded within 45 days after the last day prescribed for filing the return of such tax (determined without regard to any extension of time for filing the return) or, in the case of a return filed after such last date, is refunded within 45 days after the date the return is filed, no interest shall be allowed under subsection (a) on such overpayment.

(2) Refunds after claim for credit or refund. If—

(A) the taxpayer files a claim for a credit or refund for any overpayment of tax imposed by this title, and

(B) such overpayment is refunded within 45 days after such claim is filed, no interest shall be allowed on such overpayment from the date the claim is filed until the day the refund is made.

(3) IRS initiated adjustments. If an adjustment initiated by the Secretary, results in a refund or credit of an overpayment, interest on such

overpayment shall be computed by subtracting 45 days from the number of days interest would otherwise be allowed with respect to such overpayment.

(f) Refund of income tax caused by carryback or adjustment for certain unused deductions.

(1) Net operating loss or capital loss carryback. For purposes of subsection (a), if any overpayment of tax imposed by subtitle A [26 U.S.C. §§ 1 et seq.] results from a carryback of a net operating loss or net capital loss, such overpayment shall be deemed not to have been made prior to the filing date for the taxable year in which such net operating loss or net capital loss arises.

(2) Foreign tax credit carrybacks. For purposes of subsection (a), if any overpayment of tax imposed by subtitle A [26 U.S.C. §§ 1 et seq.] results from a carryback of tax paid or accrued to foreign countries or possessions of the United States, such overpayment shall be deemed not to have been made before the filing date for the taxable year in which such taxes were in fact paid or accrued, or, with respect to any portion of such credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such overpayment shall be deemed not to have been made before the filing date for such subsequent taxable year.

(3) Certain credit carrybacks.

(A) In general. For purposes of subsection (a), if

any overpayment of tax imposed by subtitle A [26 U.S.C. §§ 1 et seq.] results from a credit carryback, such overpayment shall be deemed not to have been made before the filing date for the taxable year in which such credit carryback arises, or, with respect to any portion of a credit carryback from a taxable year attributable to a net operating loss carryback, capital loss carryback, or other credit carryback from a subsequent taxable year, such overpayment shall be deemed not to have been made before the filing date for such subsequent taxable year.

(B) Credit carryback defined. For purposes of this paragraph, the term "credit carryback" has the meaning given such term by section 6511(d)(4)(C) [26 U.S.C. § 6511(d)(4)(C)].

(4) Special rules for paragraphs (1), (2), and (3).

(A) Filing date. For purposes of this subsection, the term "filing date" means the last date prescribed for filing the return of tax imposed by subtitle A [26 U.S.C. §§ 1 et seq.] for the taxable year (determined without regard to extensions).

(B) Coordination with subsection (e).

(i) In general. For purposes of subsection (e)--(I) any overpayment described in paragraph (1), (2), or (3) shall be treated as an overpayment for the loss year, and (II) such subsection shall be applied with respect to such overpayment by treating the return for the loss year as not filed before claim for such overpayment is filed.

(ii) Loss year. For purposes of this subparagraph, the term "loss year" means—

(I) in the case of a carryback of a net operating loss or net capital loss, the taxable year in which such loss arises,

(II) in the case of a carryback of taxes paid or accrued to foreign countries or possessions of the United States, the taxable year in which such taxes were in fact paid or accrued (or, with respect to any portion of such carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such subsequent taxable year), and

(III) in the case of a credit carryback (as defined in paragraph (3)(B)), the taxable year in which such credit carryback arises (or, with respect to any portion of a credit carryback from a taxable year attributable to a net operating loss carryback, a capital loss carryback, or other credit carryback from a subsequent taxable year, such subsequent taxable year).

(C) Application of subparagraph (B) where section 6411(a) [26 U.S.C. § 6411(a)] claim filed. For purposes of subparagraph (B)(i)(II), if a taxpayer—

(i) files a claim for refund of any overpayment described in paragraph (1), (2), or (3) with respect to the taxable year to which a loss or credit is carried back, and

(ii) subsequently files an application under

section 6411(a) [26 U.S.C. § 6411(a)] with respect to such overpayment, then the claim for overpayment shall be treated as having been filed on the date the application under section 6411(a) [26 U.S.C. § 6411(a)6411(a)] was filed.

(g) No interest until return in processible form.

(1) For purposes of subsections (b)(3) and (e), a return shall not be treated as filed until it is filed in processible form.

(2) For purposes of paragraph (1), a return is in a processible form if—

(A) such return is filed on a permitted form, and

(B) such return contains—

(i) the taxpayer's name, address, and identifying number and the required signature, and

(ii) sufficient required information (whether on the return or on required attachments) to permit the mathematical verification of tax liability shown on the return.

(h) Prohibition of administrative review. For prohibition of administrative review, see section 6406 [26 U.S.C. § 6406].

26 U.S.C. § 6511

§ 6511. Limitations on credit or refund

(a) Period of limitation on filing claim. Claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid. Claim for credit or refund of an overpayment of any tax imposed by this title which is required to be paid by means of a stamp shall be filed by the taxpayer within 3 years from the time the tax was paid.

(b) Limitation on allowance of credits and refunds.

(1) Filing of claim within prescribed period. No credit or refund shall be allowed or made after the expiration of the period of limitation prescribed in subsection (a) for the filing of a claim for credit or refund, unless a claim for credit or refund is filed by the taxpayer within such period.

(2) Limit on amount of credit or refund.

(A) Limit where claim filed within 3-year period. If the claim was filed by the taxpayer during the 3-year period prescribed in subsection (a), the amount of the credit or refund shall not exceed the portion of the tax paid within the period, immediately preceding the filing of the claim, equal to 3 years plus the

period of any extension of time for filing the return. If the tax was required to be paid by means of a stamp, the amount of the credit or refund shall not exceed the portion of the tax paid within the 3 years immediately preceding the filing of the claim.

(B) Limit where claim not filed within 3-year period. If the claim was not filed within such 3-year period, the amount of the credit or refund shall not exceed the portion of the tax paid during the 2 years immediately preceding the filing of the claim.

(C) Limit if no claim filed. If no claim was filed, the credit or refund shall not exceed the amount which would be allowable under subparagraph (A) or (B), as the case may be, if claim was filed on the date the credit or refund is allowed.

(c) Special rules applicable in case of extension of time by agreement. If an agreement under the provisions of section 6501(c)(4) [26 U.S.C. § 6501(c)(4)] extending the period for assessment of a tax imposed by this title is made within the period prescribed in subsection (a) for the filing of a claim for credit or refund—

(1) Time for filing claim. The period for filing claim for credit or refund or for making credit or refund if no claim is filed, provided in subsections (a) and (b)(1), shall not expire prior to 6 months after the expiration of the period within which an assessment may be made pursuant to the agreement or any extension thereof under section 6501(c)(4) [26 U.S.C. § 6501(c)(4)].

(2) Limit on amount. If a claim is filed, or a credit or refund is allowed when no claim was filed, after the execution of the agreement and within 6 months after the expiration of the period within which an assessment may be made pursuant to the agreement or any extension thereof, the amount of the credit or refund shall not exceed the portion of the tax paid after the execution of the agreement and before the filing of the claim or the making of the credit or refund, as the case may be, plus the portion of the tax paid within the period which would be applicable under subsection (b)(2) if a claim had been filed on the date the agreement was executed.

(3) Claims not subject to special rule. This subsection shall not apply in the case of a claim filed, or credit or refund allowed if no claim is filed, either—

(A) prior to the execution of the agreement or

(B) more than 6 months after the expiration of the period within which an assessment may be made pursuant to the agreement or any extension thereof.

(d) Special rules applicable to income taxes.

(1) Seven-year period of limitation with respect to bad debts and worthless securities. If the claim for credit or refund relates to an overpayment of tax imposed by subtitle A [26 U.S.C. §§ 1 et seq.] on account of—

(A) The deductibility by the taxpayer, under section 166 [26 U.S.C. § 166] or section 832(c) [26

U.S.C. § 832(c)], of a debt as a debt which became worthless, or, under section 165(g) [26 U.S.C. § 165(g)], of a loss from worthlessness of a security, or

(B) The effect that the deductibility of a debt or loss described in subparagraph (A) has on the application to the taxpayer of a carryover, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be 7 years from the date prescribed by law for filing the return for the year with respect to which the claim is made. If the claim for credit or refund relates to an overpayment on account of the effect that the deductibility of such a debt or loss has on the application to the taxpayer of a carryback, the period shall be either 7 years from the date prescribed by law for filing the return for the year of the net operating loss which results in such carryback or the period prescribed in paragraph (2) of this subsection, whichever expires the later. In the case of a claim described in this paragraph the amount of the credit or refund may exceed the portion of the tax paid within the period prescribed in subsection (b)(2) or (c), whichever is applicable, to the extent of the amount of the overpayment attributable to the deductibility of items described in this paragraph.

(2) Special period of limitation with respect to net operating loss or capital loss carrybacks.

(A) Period of limitation. If the claim for credit or refund relates to an overpayment attributable to a net operating loss carryback or a capital loss carryback, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that

period which ends 3 years after the time prescribed by law for filing the return (including extensions thereof) for the taxable year of the net operating loss or net capital loss which results in such carryback, or the period prescribed in subsection (c) in respect of such taxable year, whichever expires later. In the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in subsection (b)(2) or (c), whichever is applicable to the extent of the amount of the overpayment attributable to such carryback.

(B) Applicable rules.

(i) In general. If the allowance of a credit or refund of an overpayment of tax attributable to a net operating loss carryback or a capital loss carryback is otherwise prevented by the operation of any law or rule of law other than section 7122 [26 U.S.C. § 7122] (relating to compromises), such credit or refund may be allowed or made, if claim therefore is filed within the period provided in subparagraph (A) of this paragraph.

(ii) Tentative carryback adjustments. If the allowance of an application, credit, or refund of a decrease in tax determined under section 6411(b) [26 U.S.C. § 6411(b)] is otherwise prevented by the operation of any law or rule of law other than section 7122 [26 U.S.C. § 7122], such application, credit, or refund may be allowed or made if application for a tentative carryback adjustment is made within the period provided in section 6411(a) [26 U.S.C. § 6411(a)].

(iii) Determinations by courts to be conclusive. In the case of any such claim for credit or refund or any such application for a tentative carryback adjustment, the determination by any court, including the Tax Court, in any proceeding in which the decision of the court has become final, shall be conclusive except with respect to—

(I) the net operating loss deduction and the effect of such deduction, and

(II) the determination of a short-term capital loss and the effect of such short-term capital loss, to the extent that such deduction or short-term capital loss is affected by a carryback which was not an issue in such proceeding.

(3) Special rules relating to foreign tax credit.

(A) Special period of limitation with respect to foreign taxes paid or accrued. If the claim for credit or refund relates to an overpayment attributable to any taxes paid or accrued to any foreign country or to any possession of the United States for which credit is allowed against the tax imposed by subtitle A [26 U.S.C. §§ 1 et seq.] in accordance with the provisions of section 901 [26 U.S.C. § 901] or the provisions of any treaty to which the United States is a party, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be 10 years from the date prescribed by law for filing the return for the year in which such taxes were actually paid or accrued.

(B) Exception in the case of foreign taxes paid or

accrued. In the case of a claim described in subparagraph (A), the amount of the credit or refund may exceed the portion of the tax paid within the period provided in subsection (b) or (c), whichever is applicable, to the extent of the amount of the overpayment attributable to the allowance of a credit for the taxes described in subparagraph (A).

(4) Special period of limitation with respect to certain credit carrybacks.

(A) Period of limitation. If the claim for credit or refund relates to an overpayment attributable to a credit carryback, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends 3 years after the time prescribed by law for filing the return (including extensions thereof) for the taxable year of the unused credit which results in such carryback (or, with respect to any portion of a credit carryback from a taxable year attributable to a net operating loss carryback, capital loss carryback, or other credit carryback from a subsequent taxable year, the period shall be that period which ends 3 years after the time prescribed by law for filing the return, including extensions thereof, for such subsequent taxable year) or the period prescribed in subsection (c) in respect of such taxable year, whichever expires later. In the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in subsection (b)(2) or (c), whichever is applicable, to the extent of the amount of the overpayment attributable to such carryback.

(B) Applicable rules. If the allowance of a credit or

refund of an overpayment of tax attributable to a credit carryback is otherwise prevented by the operation of any law or rule of law other than section 7122 [26 U.S.C. § 7122], relating to compromises, such credit or refund may be allowed or made, if claim therefor is filed within the period provided in subparagraph (A) of this paragraph. In the case of any such claim for credit or refund, the determination by any court, including the Tax Court, in any proceeding in which the decision of the court has become final, shall not be conclusive with respect to any credit, and the effect of such credit, to the extent that such credit is affected by a credit carryback which was not in issue in such proceeding.

(C) Credit carryback defined. For purposes of this paragraph, the term "credit carryback" means any business carryback under section 39 [26 U.S.C. § 39].

(5) Special period of limitation with respect to self-employment tax in certain cases. If the claim for credit or refund relates to an overpayment of the tax imposed by chapter 2 (26 U.S.C. §§ 1401 et seq.) (relating to the tax on self-employment income) attributable to an agreement, or modification of an agreement, made pursuant to section 218 of the Social Security Act [42 U.S.C. § 418] (relating to coverage of State and local employees), and if the allowance of a credit or refund of such overpayment is otherwise prevented by the operation of any law or rule of law other than section 7122 [26 U.S.C. § 7122] (relating to compromises), such credit or refund may be allowed or made if claim therefor is filed on or before the last day of the second year after the calendar year in which such agreement (or

modification) is agreed to by the State and the Commissioner of Social Security.

(6) Special period of limitation with respect to amounts included in income subsequently recaptured under qualified plan termination. If the claim for credit or refund relates to an overpayment of tax imposed by subtitle A [26 U.S.C. §§ 1 et seq.] on account of the recapture, under section 4045 of the Employee Retirement Income Security Act of 1974 [29 U.S.C. § 1345], of amounts included in income for a prior taxable year, the 3-year period of limitation prescribed in subsection (a) shall be extended, for purposes of permitting a credit or refund of the amount of the recapture, until the date which occurs one year after the date on which such recaptured amount is paid by the taxpayer.

(7) Special period of limitation with respect to self-employment tax in certain cases. If—

(A) the claim for credit or refund relates to an overpayment of the tax imposed by chapter 2 [26 U.S.C. §§ 1401 et seq.] (relating to the tax on self-employment income) attributable to Tax Court determination in a proceeding under section 7436 [26 U.S.C. § 7436], and

(B) the allowance of a credit or refund of such overpayment is otherwise prevented by the operation of any law or rule of law other than section 7122 [26 U.S.C. § 7122] (relating to compromises), such credit or refund may be allowed or made if claim therefor is filed on or before the last day of the second year after the calendar year in which such determination

becomes final.

(8) Special rules when uniformed services retired pay is reduced as a result of award of disability compensation.

(A) Period of limitation on filing claim. If the claim for credit or refund relates to an overpayment of tax imposed by subtitle A [26 U.S.C. §§ 1 et seq.] on account of—

(i) the reduction of uniformed services retired pay computed under section 1406 or 1407 of title 10, United States Code, or

(ii) the waiver of such pay under section 5305 of title 38 of such Code, as a result of an award of compensation under title 38 of such Code pursuant to a determination by the Secretary of Veterans Affairs, the 3-year period of limitation prescribed in subsection (a) shall be extended, for purposes of permitting a credit or refund based upon the amount of such reduction or waiver, until the end of the 1-year period beginning on the date of such determination.

(B) Limitation to 5 taxable years. Subparagraph (A) shall not apply with respect to any taxable year which began more than 5 years before the date of such determination.

(e) Repealed.

(f) Special rule for chapter 42 and similar taxes. For purposes of any tax imposed by section 4912 [26 U.S.C. § 4912], chapter 42 [26 U.S.C. §§ 4940 et seq.],

or section 4975 [26 U.S.C. § 4975], the return referred to in subsection (a) shall be the return specified in section 6501(l)(1) [26 U.S.C. § 6501(1)(1)].

(g) Special rule for claims with respect to partnership items. In the case of any tax imposed by subtitle A [26 U.S.C. §§ 1 et seq.] with respect to any person which is attributable to any partnership item (as defined in section 6231(a)(3) [26 U.S.C. § 6231(a)(3)]), the provisions of section 6227 [26 U.S.C. § 6227] and subsections (c) and (d) of section 6230 [26 U.S.C. § 6230] shall apply in lieu of the provisions of this subchapter [26 U.S.C. §§ 6511 et seq.].

(h) Running of periods of limitation suspended while taxpayer is unable to manage financial affairs due to disability.

(1) In general. In the case of an individual, the running of the periods specified in subsections (a), (b), and (c) shall be suspended during any period of such individual's life that such individual is financially disabled.

(2) Financially disabled.

(A) In general. For purposes of paragraph (1), an individual is financially disabled if such individual is unable to manage his financial affairs by reason of a medically determinable physical or mental impairment of the individual which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months. An individual shall not be considered to have such an impairment unless proof

of the existence thereof is furnished in such form and manner as the Secretary may require.

(B) Exception where individual has guardian, etc. An individual shall not be treated as financially disabled during any period that such individual's spouse or any other person is authorized to act on behalf of such individual in financial matters.

(i) Cross references.

(1) For time return deemed filed and tax considered paid, see section 6513 [26 U.S.C. § 6513].

(2) For limitations with respect to certain credits against estate tax, see sections 2014(b) and 2015 [26 U.S.C. §§ 2014(b) and 2015].

(3) For limitations in case of floor stocks refunds, see section 6412 [26 U.S.C. § 6412].

(4) For a period of limitations for credit or refund in the case of joint income returns after separate returns have been filed, see section 6013(b)(3) [26 U.S.C. § 6013(b)(3)].

(5) For limitations in case of payments under section 6420 [26 U.S.C. § 6420] (relating to gasoline used on farms), see section 6420(b) [26 U.S.C. § 6420(b)].

(6) For limitations in case of payments under section 6421 [26 U.S.C. § 6421] (relating to gasoline used for certain nonhighway purposes or by local transit systems), see section 6421(d) [26 U.S.C. §

6421(d)].

(7) For a period of limitations for refund of an overpayment of penalties imposed under section 6694 or 6695 [26 U.S.C. § 6694 or 6695], see section 6696(d)(2) [26 U.S.C. § 6696(d)(2)].

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4 CMC § 1701

§ 1701. Application of the Internal Revenue Code, In General.

(a) The United States Internal Revenue Code ("Internal Revenue Code" or "IRC"), made applicable by this chapter, is a statute adopted as a local territorial income tax. The IRC as herein incorporated is made a part of Commonwealth law, and may be cited as the "Northern Marianas Territorial Income Tax" ("NMTIT").

(b) The administration and enforcement of the NMTIT shall be performed by or under the supervision of the Governor. Any function needful to the administration and enforcement of the NMTIT shall be performed by any officer or employee of the government of the Commonwealth duly authorized by the Governor (either directly, or indirectly by one or more redelegations of authority) to perform such function.

(c) The Governor or his delegate shall have the same administrative and enforcement powers with regard to the NMTIT as the Secretary of the Treasury and

other United States officials of the executive branch have with respect to the United States income tax. Needful rules and regulations for enforcement of the NMTIT shall be prescribed by the Governor or his delegate pursuant to 4 CMC § 1818. The Governor or ---taxpayer. The application fee will not be returned to the taxpayer.

(1) The secretary may prescribe regulations to carry out the purpose and intent of this section.

Commission Comment: With respect to the references to the "Chief of the Division of Revenue and Taxation, Department of Finance," the "Secretary of Finance," and the "Department of Finance," see Executive Order 94-3 (effective August 23, 1994), reorganizing the executive branch, changing agency names and official titles, and effecting other changes, set forth in the commission comment to 1 CMS § 2001.

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4 CMC § 1708

§ 1708. Tax Relief.

(a) *General Rule.* Every person subject to the NMTIT shall be entitled to a rebate in the amount determined under subsection (b) of this section. Every taxpayer shall be entitled to apply all or part of any rebate due to any tax reported on the return (including penalties and interest) and not previously paid; provided, that this right of offset shall not reduce or eliminate any penalty or liability under the NMTIT on account of underpayment.

4 CMC § 1711

§ 1711. Rebate Offset Procedure.

(a) Amounts properly subject to rebate offset under 4 CMC § 1708 shall be rebated by filing a timely income tax return which includes the claim for rebate offset form for the taxable year to which the rebate offset relates. However, claims for rebate offset under this division shall not be subject to 1 CMC § 2553(k).

(b) The amount of the rebate offset shall be made as soon as practicable, but no later than six months from the due date of the return or the date of filing, whichever is later.

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4 CMC § 1715

§ 1715. Shortfall in Trust Account.

With regard to the trust accounts created and authorized by 4 CMC § 1714, if the Secretary of Finance deems it necessary because there are insufficient trust account proceeds, he may withdraw funds from the General Fund to meet any liabilities of the trust accounts.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN MARIANA ISLANDS

AMANDA ARMSTRONG, *et al.*,	] Civil Action No. 07-0002
Plaintiffs	]
v.	] ORDER GRANTING DEFENDANT'S MOTION
COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS, Acting by and through its DEPARTMENT OF FINANCE,	] TO DISMISS FOR LACK OF SUBJECT MATTER JURISDICTION
Defendant	]

THIS MATTER came before the court on Wednesday, May 23, 2007, for hearing of defendant's Fed.R.Civ.P. 12(b)(1) motion to dismiss for lack of subject matter jurisdiction. Plaintiffs appeared by and through their attorney, Alexis A. Fallon; defendant appeared by and through its attorney, Commonwealth assistant Attorney General R. Anthony Welch.

THE COURT, having considered the written[1] and

[1] Defendant's reply brief was not filed until shortly before the hearing. The court had not seen it prior to the hearing and plaintiff's counsel had only had an opportunity to read quickly through it. The court's records do not reflect that it had issued an order allowing late filing of the reply brief, nor do they reflect a stipulation between the parties agreeing to such a late

oral arguments of counsel, grants the motion to dismiss for lack of subject matter jurisdiction for the following reasons.

Defendant argues that the court lacks subject matter jurisdiction because of the issue before it does not present a federal question and no other basis for jurisdiction is alleged. Plaintiff responds that the court has original jurisdiction by virtue of sections 601 and 602 of the Covenant[2] and Title 48, U.S. Code §§ 1822 and 1843 (c).

By this lawsuit, plaintiffs seek to require the Commonwealth government to obey Commonwealth law. Specifically, they ask this court to order the Commonwealth to pay tax rebates to which plaintiffs allege they are due or to provide a "meaningful offset" to their tax liability, to require the Commonwealth to pay interest on the unpaid rebates, to waive any exhaustion-of-remedies requirement, and for other, miscellaneous relief.

The court concludes that it lacks subject matter jurisdiction over these claims because there is no federal question jurisdiction. Covenant sections 601 and 602 do not confer jurisdiction on this court to entertain lawsuits based on Commonwealth law. Although it is undeniably true that the Commonwealth has adopted the "income tax laws in

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filing. For these reasons, the court has not considered defendant's reply brief in making its decision on the motion.

[2] "Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America," Act of Mar. 24, 1976, Pub. L. No. 94-241, 90 Stat. 263 (codified as amended at 48 U.S.C § 1681 (1988)) (hereinafter "Covenant").

force in the United States," they came into force in the Commonwealth "as a *local* territorial income tax." (Emphasis added.) Section 602 authorizes the Commonwealth government to enact other tax laws and to provide rebates under the "local territorial income tax," subject to the limitation that such rebates "be limited to taxes derived from sources within the Northern Mariana Islands."

Section 1843(c) of Title 48, U.S. Code, places upon the Commonwealth government the requirement that it "maintain, as a matter of public record, the name and address of each person receiving such rebate." Because section 1843 was enacted as a federal statute by the United States Congress, this court has federal question jurisdiction to entertain any lawsuit based on that statute. *See, e.g.* Olopai v. De Leon Guerrero, "Memorandum Opinion and Order," N.M.I. District Court Civil No 93-0002, (Sept. 24, 1993). However, neither that statute nor 48 U.S.C. § 1822 bestows upon the court jurisdiction to hear this lawsuit, which seeks an order directing the Commonwealth government to adhere to the territorial income tax law and pay allegedly tardy tax rebates.[3]

The court lacks subject matter jurisdiction to decide the issue presented to it. Accordingly, this lawsuit is dismissed.

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[3] The court's subject matter jurisdiction would very likely be properly invoked in a lawsuit brought by or against the U.S. Internal Revenue Service, or otherwise involving United States tax laws.

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN MARIANA ISLANDS

AMANDA ARMSTRONG, *et al.*,	] Civil Action No. 07-0002
Plaintiffs	]
v.	] JUDGMENT
COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS, Acting by and through its DEPARTMENT OF FINANCE,	]
Defendant	]

THIS MATTER having been dismissed with prejudice for lack of subject matter jurisdiction by order dated May 24, 2007,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that plaintiffs shall take nothing and judgment is entered in favor of defendant. The parties shall bear their own costs and fees.

DATED this 5th day of June, 2007.

s/ Alex R. Munson
ALEX R. MUNSON
Judge

IT IS SO ORDERED.

DATED this 24th day of May, 2007.

s/ Alex R. Munson
ALEX R. MUNSON
Judge

APPENDIX D

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[Filed August 7, 2009]

AMANDA ARMSTRONG; HUI MIN ZHAO; XIU ZHEN QI; MEI LIAN CHEN; EDWARD LIEBERMAN; JOHN DOES,

Plaintiffs-Appellants,

v.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS; DEPARTMENT OF FINANCE,

Defendants-Appellees.

No. 07-16126
D.C. No. CV-07-00002-ARM

Appeal from the United States District Court
for the District Of The Northern Mariana Islands
Alex R. Munson, District Judge, Presiding

Argued and Submitted
November 18, 2008 - Honolulu, Hawaii

Before: Mary M. Schroeder, Richard A. Paez, and N. Randy Smith, Circuit Judges.

OPINION BY JUDGE PAEZ

OPINION

PAEZ, Circuit Judge:

Amanda Armstrong and twenty-eight taxpayers (hereinafter referred to collectively as "Armstrong") appeal from the district court's order dismissing their action against the Commonwealth of the Northern Mariana Islands ("CNMI") seeking recovery of income tax rebates and accrued interest under the CNMI tax code. Armstrong also seeks declaratory and injunctive relief regarding the manner in which the CNMI government administers the payment of rebates. The district court concluded that it lacked subject matter jurisdiction over the claims, and dismissed the action pursuant to Federal Rule of Civil Procedure 12(b)(1).

Armstrong contends first that the district court had federal question jurisdiction over the claims under 28 U.S.C. § 1331 because the CNMI has adopted the Internal Revenue Code, 26 U.S.C. § 1 *et seq.* ("IRC"), as a local territorial income tax called the Northern Mariana Territorial Income Tax ("NMTIT"). Armstrong argues that because the provisions of the NMTIT "mirror" those of the IRC, claims that arise under the NMTIT raise a federal question and therefore "arise under" the laws of the United States for the purposes of § 1331.

Armstrong also argues that the district court had original jurisdiction over her claims pursuant to a provision in the *Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America* ("Covenant"), *reprinted in* 48 U.S.C. § 1801 (note), [1] which provides that the United States tax laws shall be adopted by the CNMI as a local territorial income tax and shall be in force in the same manner as those laws are in force in Guam. Thus, argues Armstrong, just as the Guam district court has jurisdiction over tax-related matters that arise under the provisions of Guam's tax code, which also mirrors United States tax laws, the CNMI district court has jurisdiction over tax-related matters that arise under the provisions of the CNMI's tax code.

We have jurisdiction under 28 U.S.C. § 1291 and 48 U.S.C. § 1821(a). Because we agree with the district court's determination that it lacked subject matter jurisdiction over Armstrong's claims, we affirm.

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[1] In her reply brief, Armstrong also argued that because the tax rebate claims "arise out of and directly concern the scope and effect" of the Covenant, the district court had jurisdiction pursuant to Covenant § 903, reprinted in 48 U.S.C. § 1801 (note), which provides that "[n]othing herein shall prevent the presentation of cases or controversies arising under this Covenant to courts established by the Constitution or laws of the United States." At oral argument, however, Armstrong withdrew this additional argument. We therefore need not address either its merits or whether, as the CNMI contends, Armstrong waived the argument by not raising it in the district court or in her opening brief.

I.

BACKGROUND

A. The CNMI Covenant and adoption of federal tax law as a local territorial tax system

From 1947 until 1986, what is now the CNMI was a trust territory administered by the United States pursuant to an agreement with the Security Council of the United Nations. *See generally* Joseph E. Horey, *The Right of Self-Government in the Commonwealth of the Northern Mariana Islands*, 4 Asian-Pac. Law & Policy Journal 180, 181 (2003) (providing brief overview of CNMI history); *see also* 48 U.S.C. § 1801 (quoting language of Pub. L. 94-241, describing trusteeship terms); *United States v. De Leon Guerrero*, 4 F.3d 749, 751 (9th Cir. 1993). In 1972, the Islands entered into formal negotiations with the United States to finalize and make permanent the relationship between the entities. *See id.*

On February 15, 1975, the negotiations culminated with the signing of the Covenant. [2] *See De Leon Guerrero*, 4 F.3d at 751; *see also* Horey, 4 Asian-Pac. Law & Policy Journal at 181-85 (describing history of Covenant and several Covenant provisions). This instrument, which governs the CNMI's political relationship with the United States, provides that the United States District Court for the Northern Mariana Islands ("NMI district court"), as a court established under Article IV of the United States Constitution, shall have the same jurisdiction

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[2] In 1986, with the Covenant fully in effect, the United States—by Presidential Proclamation—terminated the Trusteeship Agreement with respect to the CNMI. *See De Leon Guerrero*, 4 F.3d at 751.

as other United States District Courts. *See* Covenant § 402(a), *codified as amended at* 48 U.S.C. § 1822; *see also Nguyen v. United States*, 539 U.S. 69, 72-73, 123 S. Ct. 2130, 156 L. Ed. 2d 64 (2003) (describing how jurisdiction is vested in Article IV courts by acts of Congress).

The Covenant also contains provisions that govern the adoption of an income tax system for the CNMI. First, Covenant section 601 provides that "[t]he income tax laws in force in the United States will come into force in the Northern Mariana Islands as a local territorial income tax on the first day of January following the effective date of this Section, in the same manner as those laws are in force in Guam." To implement this provision, the CNMI legislature adopted the NMTIT, enacting the Northern Marianas Income Tax Act of 1982 and 1984, currently codified as amended in the Northern Mariana Islands Commonwealth Code ("CMC") at 4 CMC §§ 1701-17 (2004). *See* N. Mar. I. Pub. L. 3-11 (May 27, 1982), N. Mar. I. Pub. L. 4-24 (Dec. 11, 1984), N. Mar. I. Pub. L. 9-22, § 6 (Jan.24, 1995).

Under the NMTIT, CNMI taxpayers

> are not required to pay federal income taxes to the United States Internal Revenue Service. However, over the course of a tax year, a CNMI taxpayer pays the exact same amount of tax to the CNMI government, through either payroll withholding deductions or quarterly payments, as a citizen of one of the several States with the same income would pay to the United States government

Olopai v. Guerrero, No. 93-0002, 1993 U.S. Dist. LEXIS 13839, 1993 WL 384960, at *1 (D. N. Mar. I. Sept. 24, 1993); *see* 4 CMC § 1802 (describing a General Fund "into which all revenues raised pursuant to the tax laws and other revenue laws . . . . . shall be deposited. . . .").

Section 601's provision that the CNMI shall adopt the United States tax laws as a local territorial income tax constitutes what is commonly referred to as a "mirror code" system. Congress has described such systems, which are implemented in several insular areas, including Guam, the Virgin Islands, and Puerto Rico, as "the provisions of law . . . which make the provisions of the income tax laws of the United States . . . in effect in a possession of the United States." 26 U.S.C. § 931 (note); *see* 48 U.S.C. § 1421i (Guam); 48 U.S.C. § 1397 (Virgin Islands); 48 U.S.C. § 734 (Puerto Rico).

In addition to Covenant section 601, Covenant section 602 authorizes the CNMI to enact additional local tax laws: "The Government of the Northern Mariana Islands may by local law impose such taxes, in addition to those imposed under section 601, as it deems appropriate and provide for the rebate of any taxes received by it . . . ." 48 U.S.C. § 1801 (note). Accordingly, several provisions of the NMTIT impose additional tax obligations on the CNMI and its taxpayers, and set forth a procedure by which CNMI taxpayers may obtain significant rebates on taxes owed. *See* 4 CMC § 1708 (establishing rebate amounts); 4 CMC § 1711(b) (establishing rebate procedures); 4 CMC § 1713 (specifying that the interest on overpayments shall be calculated only on the amount not already rebated); 4 CMC § 1714

(discussing special rebate trust account); 4 CMC § 1810(b) (discussing authority to make refunds).

B. Armstrong's Claims

On January 19, 2007, Armstrong filed a complaint in the NMI district court. [3] She alleged, on behalf of herself and all others similarly situated, that the CNMI failed to calculate and pay statutory interest due on accrued rebate claims in violation of the NMTIT. Armstrong sought a judicial declaration that (1) interest applies to late-paid CNMI rebates; (2) the CNMI government is required to pay such interest; (3) CNMI taxpayers are entitled to offset their accrued rebates, plus interest, as a credit against taxes owed on wages; and (4) the CNMI government is estopped from asserting the applicable statute of limitations contained in 26 U.S.C. § 6511, due to the CNMI government's inaccurate representations that CNMI taxpayers were not entitled to interest on late-paid rebates.

Armstrong also sought injunctive relief enjoining the CNMI government from expending funds set aside in the Special Rebate Trust Account, as required by 4 CMC § 1714, so that the outstanding and accrued rebate claims could be satisfied. Last, Armstrong sought payment of accrued interest, in amounts to be proven at trial.

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[3] Because the district court dismissed Armstrong's action under Federal Rule of Civil Procedure 12(b)(1) without making any factual findings, we take the allegations in the complaint as true. *Ojo v. Farmers Group, Inc.*, 565 F.3d 1175, 1183 (9th Cir. 2009) (quoting *Carson Harbor Village Ltd. v. City of Carson*, 353 F.3d 824, 826 (9th Cir. 2004)).

C. The District Court's Ruling

In response to Armstrong's complaint, the CNMI moved to dismiss under Federal Rule of Civil Procedure 12(b)(1) on the ground that the district court lacked subject matter jurisdiction. The district court granted the CNMI's motion. Although the court recognized that the CNMI adopted the United States tax laws as required by the Covenant, it reasoned that those laws came into force as *local* territorial taxes, and that therefore no provision in the Covenant--and no other authority-- authorized the court to exercise jurisdiction over claims seeking enforcement of these local laws. Armstrong timely appealed.

II.

ANALYSIS

Armstrong presents two arguments that the district court had subject matter jurisdiction over her claim.[4] We address, and reject, each in turn.

First, Armstrong contends that the claims invoke federal question jurisdiction under 28 U.S.C. § 1331. Because the rebate provisions of the NMTIT provide the legal basis for Armstrong's rebate claims, however, we conclude that the claims do not arise under federal law for the purposes of federal question jurisdiction.

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[4] We review de novo the district court's decision to dismiss a complaint under Federal Rule of Civil Procedure 12(b)(1). *Stratman v. Leisnoi, Inc.*, 545 F.3d 1161, 1167 (9th Cir. 2008); *Wah Chang v. Duke Energy Trading & Mktg., LLC*, 507 F.3d 1222, 1225 (9th Cir. 2007).

Second, Armstrong argues that the court had original jurisdiction over the claims under Covenant section 601, which provides that the United States tax laws shall be in force in the CNMI in the same manner as they are in force in Guam. Although in Guam, the district court has exclusive jurisdiction over tax-related claims, the instrument that governs Guam's relationship with the United States--and that confers exclusive jurisdiction over tax matters to the United States District Court for Guam--is entirely different from the Covenant that governs the CNMI's relationship with the United States. *See* 48 U.S.C. § 1421i. We see no reason to interpret section 601's reference to Guam to incorporate a jurisdictional provision that is (1) specific to the United States's relationship with Guam and (2) not contained in either the Covenant or the IRC.

A. Federal Question Jurisdiction

Armstrong contends that because the provisions of the NMTIT "mirror" the provisions of the IRC, the claims she brought under the NMTIT necessarily implicate questions of federal law and are therefore subject to federal question jurisdiction under 28 U.S.C. § 1331. We disagree.

Section 1331 provides that "[t]he district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States." As noted above, section 402(a) of the Covenant affirms that the United States District Court for the Northern Mariana Islands shares the same jurisdiction as a district court of the United States. Thus, if Armstrong's claims "aris[e] under the Constitution, laws, or treaties of the United States,"

the NMI district court would have federal question jurisdiction and could address the merits of her claims.

"The Court has consistently interpreted jurisdictional statutes with an 'arising under' qualification," including § 1331, "as 'giv[ing] the lower federal courts jurisdiction to hear, originally or by removal from a state court, only those cases in which a well-pleaded complaint establishes either that [1] federal law creates the cause of action or that [2] the plaintiff's right to relief necessarily depends on resolution of a substantial question of federal law.'" *Williston Basin Interstate Pipeline Co. v. An Exclusive Gas Storage Leasehold and Easement in the Cloverly Subterranean Geological Formation*, 524 F.3d 1090, 1100 (9th Cir. 2008) (quoting *Franchise Tax. Bd. v. Constr. Laborers Vacation Trust*, 463 U.S. 1, 27-28, 103 S. Ct. 2841, 77 L. Ed. 2d 420 (1983)). Where, as here, plaintiffs invoke the second basis for jurisdiction--arguing not that federal law itself creates the cause of action, but instead that their right to relief necessarily depends on resolution of a substantial question of federal law --we must examine whether such question is a necessary element of one of their well-pleaded state (or, in this case, Commonwealth) claims. *See Wander v. Kaus*, 304 F.3d 856, 858 (9th Cir. 2002) (quoting *Franchise Tax. Bd.*, 463 U.S. at 13 (1983)). Because the NMTIT provisions mirror the IRC provisions, Armstrong argues that her claims "arise under" the IRC and therefore raise a disputed and substantial federal issue. *See Williston Basin*, 524 F.3d at 1100 (quoting *Grable & Sons Metal Prods., Inc. v. Darue Eng'g & Mfg.*, 545 U.S. 308, 314, 125 S. Ct. 2363, 162 L. Ed. 2d 257 (2005)).

Here, Armstrong's contention essentially amounts to an argument that because the IRC serves as the basis for the CNMI tax code, actions that arise under the NMTIT raise federal questions. Armstrong, however, presents us with no authority for her argument that under a mirror code system, it is federal law, not local law, that is in force, or that claims arising under such a system necessarily raise federal questions.[5] The Covenant's mandate that the CNMI adopt the provisions of the IRC as *local territorial* laws--which raise revenue for the CNMI government, *see Olopai*, 1993 U.S. Dist. LEXIS 13839, 1993 WL 384960, at *1-- disaffirms Armstrong's argument that Congress intended that all claims brought under the NMTIT would invoke federal question jurisdiction under § 1331. The

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[5] That the District Court of Guam has original, exclusive jurisdiction over tax-related matters arising under the Guam "mirror code," *see* 48 U.S.C. § 1421i(h)(1), does not further Armstrong's § 1331 jurisdictional argument, and the fact that at one time the District Court of the United States Virgin Islands had jurisdiction over certain tax-related matters arising under the Virgin Islands's "mirror code," *see* 33 V. I. Code Ann. tit. 33 § 1692; 48 U.S.C. § 1612, does not aid Armstrong either. *See Edwards v. Hovensa*, LLC, 497 F.3d 355, 49 V.I. 1133 (3d Cir. 2007) (explaining that the Virgin Islands's legislature withdrew such jurisdiction when it transferred jurisdiction to its local superior court). In providing for district court jurisdiction over tax-related matters in Guam and the Virgin Islands, Congress enacted specific provisions tailored to the United States's relationship with these entities. Contrary to Armstrong's suggestion, these provisions are unrelated to the Covenant, which governs the relationship between the United States and the CNMI. Indeed, the unique jurisdictional provisions in the instruments governing the United States's relationship with other territories underscores the CNMI's argument that whether a federal district court has jurisdiction over tax-related matters does not turn on whether the territorial government adheres to a "mirror code."

language of the Covenant suggests that the opposite is true.[6]

More importantly, as the district court pointed out, Armstrong's claims primarily involved the additional local provisions of the NMTIT, not the NMTIT provisions that were modeled after the IRC. In other words, Armstrong sought enforcement of local territorial income tax laws enacted pursuant to Covenant section 602. These local tax law claims do not possess, as necessary elements, "substantial, disputed" questions of federal law. *See Wander*, 304 F.3d at 858 (quoting *Franchise Tax. Bd.*, 463 U.S. at 13 (1983)).

In sum, we conclude that because the NMTIT is a local, territorial income tax code, and because Armstrong's NMTIT claims seek to enforce the additional rebate provisions enacted pursuant to Covenant section 602, Armstrong's NMTIT claims were not subject to federal question jurisdiction under 28 U.S.C. § 1331.[7]

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[6] We do not foreclose the possibility that there might be some claim under the NMTIT of such a nature that its adjudication would involve a substantial question of federal law that might give rise to jurisdiction under § 1331. *See Wander*, 304 F.3d at 858-59 ["[C]ourts should approach the issue of federal question jurisdiction as one requiring sensitive judgments about congressional intent, judicial power, and the federal question. . . . Accordingly, when determining the propriety of federal question jurisdiction, courts look both to congressional intent and the nature of the federal interest at stake."] (internal quotation marks and citation omitted)). *See also Grable & Sons*, 545 U.S. at 314; *Merrell Dow Pharms., Inc. v. Thompson*, 478 U.S. 804, 810, 106 S. Ct. 3229, 92 L. Ed. 2d 650 (1986).

[7] Armstrong briefly argues that section 1271 of the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085, which authorizes insular areas such

B. Original Jurisdiction under Covenant Section 601

Armstrong also argues that the district court had original jurisdiction over her action under Covenant section 601(a), which, as noted above, provides that the income tax laws in force in the United States will be enforced "*in the same manner as those laws are in force in Guam*" (emphasis added). Because tax-related disputes under Guam's income tax laws are subject to jurisdiction in the district court, Armstrong contends that the NMI district court has jurisdiction over disputes related to the NMTIT. Again, we disagree.

First, the Guam district court has jurisdiction over tax-related matters pursuant to a provision of the Guam Organic Act; no such provision is contained in the IRC, the NMTIT, or the Covenant. Specifically, 48 U.S.C. § 1421i(h)(1) provides, in pertinent part, that "the District Court of Guam shall have *exclusive original jurisdiction over all judicial proceedings in*

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as Guam and the CNMI to "de-link" from the mirror code income tax system under certain conditions, further demonstrates the existence of federal jurisdiction. Although Armstrong's argument is not entirely clear, we construe it as support for her § 1331 jurisdictional argument. According to Armstrong, by providing for de-linkage in section 1271, Congress implicitly recognized that the federal income tax laws are in force in the CNMI as federal law, not local law. This argument, however, disregards the mandate of Covenant section 601 as explained both above and infra at 10660, and misinterprets Congress' authorization for insular areas such as the CNMI and Guam to adopt a simplified income tax code that is tailored to the unique circumstances of each area. Further, section 1271 does not address the NMI district court's jurisdiction over tax-related claims arising under the NMTIT. In light of the text and purpose of section 1271, it does not support Armstrong's § 1331 jurisdictional argument.

Guam . . . with respect to the Guam Territorial income tax." (emphasis added). *See Gov't of Guam v. Sup. Ct. of Guam*, 998 F.2d 754, 755 (9th Cir. 1993) (affirming that 48 U.S.C. § 1421i(h) requires that all matters "involving" the territorial income tax must be litigated in the district court).

No similar provision exists in the Covenant; in fact, the Northern Marianas Tax Act of 1984, as amended, explicitly contemplates that the local superior court shall have jurisdiction over tax matters, stating that "[i]n applying the NMTIT for any purpose . . . the . . . provisions of the IRC shall be read so as to substitute 'Commonwealth of the Northern Mariana Islands' for 'United States' . . . and . . . 'Superior Court of the Northern Mariana Islands' for 'district court' . . . ." 4 CMC § 1701(e). The legislative history of Guam's Organic Act, moreover, reflects that section 1421i(h) was added in response to a unique problem Guam faced regarding uniform adjudication of refund claims pending in Guam's local court. *See* S. Rep. No. 85-2176 (1958), *as reprinted in* 1958 U.S.C.C.A.N. 3647, 3653-54.

Second, as discussed above, Covenant section 601, which directs the CNMI to adopt the federal tax laws, specifies that the applicable IRC provisions shall be enforced as *local* territorial laws. In contrast, 48 U.S.C. § 1421i provides that "[t]he income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in Guam . . . ." Use of the word "local" highlights the distinction between the CNMI's mirror code tax system and Guam's.

Last, the CNMI's enactment of the Northern Mariana Island Income Tax Act of 1982 and 1984, noted above, is best understood as reflecting the CNMI's intent to ensure that local tax disputes are adjudicated in the CNMI superior court. The Act's mandate that "superior court" shall be substituted for "district court" highlights the CNMI's intent to vest jurisdiction in the *superior court*, consistent with section 402 of the Covenant as amended. *See* 48 U.S.C. § 1822 ("The District Court for the Northern Mariana Islands shall have original jurisdiction in all causes in the Northern Mariana Islands[,] . . . jurisdiction over which is *not* vested by the Constitution or laws of the Northern Mariana Islands in a court or courts of the Northern Mariana Islands.") (emphasis added).

In sum, we are unpersuaded by Armstrong's argument that the Covenant incorporates § 1421i(h)'s grant of exclusive jurisdiction over tax matters to the United States District Court for Guam. The legislative history of § 1421i(h), the text of the Covenant, and the enactment of the Northern Mariana's Income Tax Act all suggest otherwise. We therefore conclude that the district court lacked original jurisdiction over Armstrong's NMTIT claims and properly dismissed her action.

AFFIRMED.

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

AMANDA ARMSTRONG, *et al.*,	] No. 07-16126
Plaintiffs-Appellants,	] D.C. No. CV-07-00002-ARM
v.	] District of the Northern Mariana Islands
COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS; et al.,	] ORDER
Defendants-Appellees.	]

Before: SCHROEDER, PAEZ and N.R. SMITH, Circuit Judges.

The full court was advised of the petition for rehearing en banc and no judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The petition for rehearing en banc is DENIED.

APPENDIX F

SECTION BY SECTION ANALYSIS OF THE COVENANT TO ESTABLISH A COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS

February 15, 1975 MARIANAS POLITICAL STATUS COMMISSION

SECTION BY SECTION ANALYSIS OF THE COVENANT TO ESTABLISH A COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS

The purpose of this memorandum is to explain in detail the purpose and effect of each section of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America ("Covenant") negotiated between the Marianas Political Status Commission ("MPSC") and the Personal Representative of the President of the United States. The Covenant will become effective only after approval by the people of the Northern Marianas in a plebiscite and by the United States Congress.

TITLE

The Northern Marianas political status agreement is called a "Covenant". A covenant is a binding agreement like a contract or a compact and the title

used for this agreement is not intended to have independent legal significance. This title seems appropriate because the relationship between the United States and the Northern Marianas will be a permanent one, which in its fundamental respects will not be able to be changed by one party without the consent of the other. The documents which created the only existing commonwealth in the American political family, the Commonwealth of Puerto Rico, were known as a compact, a term which is similar to the one chosen for this document.

The purpose of the Covenant is to establish a Commonwealth of the Northern Mariana Islands. A commonwealth is the name given to a self-governing political entity which is closely attached to another, larger political unit such as a nation. In this case the Commonwealth of the Northern Mariana Islands will be in permanent political union with the United States. The commonwealth relationship embodied in the Covenant is patterned after the relationship between the United States and Puerto Rico as well as the relationship between the United States and the Territory of Guam, though it contains a number of significant features not present in either of those relationships.

The MPSC studied a variety of possible relationships before choosing the commonwealth relationship. In evaluating the alternatives, the Commission was governed by the provisions of District Law No. 3-124, approved on May 17, 1972, which instructed the Commission to seek a "close political relationship" with the United States which was "different from that which has been tentatively chosen by the people of the remainder of the districts

of the Trust Territory of the Pacific Islands." The Commission concluded that the commonwealth relationship is the most satisfactory form of a close and enduring association with the United States available to the people of the Northern Marianas. The commonwealth relationship contained in the Covenant provides assurances of local self-government which would not be available under a traditional territorial relationship. On the other hand, the commonwealth relationship assures a permanent political union with the United States, permits the people of the Northern Marianas to become United States citizens, and provides other benefits which would not be available if a looser and less permanent relationship, such as free association, were adopted.

PREAMBLE

A preamble is traditional in fundamental legal documents such as the Covenant. The Preamble sets out a few of the most important reasons which led to the preparation of the Covenant. The first clause notes that under the Charter of the United Nations and under the Trusteeship Agreement itself the people of the Northern Marianas are guaranteed the right freely to express their wishes for self-government or independence. The second clause states that the United States supports the desire of the people of the Northern Marianas to exercise their inalienable right of self-determination. The third clause emphasizes that the people of the Northern Marianas and the people of the United States share the goals and values found in the American system of government, based on the principles of government by consent, individual freedom and democracy.

Because of these shared goals and values the people of the Northern Marianas and the people of the United States will enter into a permanent political union. Finally, the fourth clause takes note of the fact that for over 20 years the people of the Northern Marianas have expressed their desire for political union with the United States in public petition and in referendum. It is this desire for a close and permanent political relationship with the United States that led to the establishment of the MPSC.

The Preamble concludes with the "NOW, THEREFORE" clause. This clause states that for the reasons set forth in the introductory clauses, the MPSC, having been duly appointed by the District Legislature to represent the people of the Northern Marianas in the political status negotiations, and the Personal Representative of the President of the United States, have entered into the Covenant. The clause then states the essential purposes of the Covenant: "to establish a self-governing Commonwealth for the Northern Mariana Islands within the American political system and to define the future relationship between the Northern Mariana Islands and the United States." The clause also states that the Covenant will be bending on both the Northern Marianas and the United States after it is approved by the Mariana Islands District Legislature, by the people of the Northern Marianas in a plebiscite, and by the United States. The mechanism by which the Covenant is to be approved is spelled out in detail in Section 1001. Once the Covenant becomes mutually binding, the political relationship between the United States and the Northern Marianas will be permanent, and neither side will be able to alter it in any fundamental

respect without the consent of the other. Finally, and fundamentally, this clause of the Preamble recognizes that the approval of the Covenant by the people of the Northern Marianas will constitute on their part a sovereign act of self-determination – an exercise of their right freely to express their wishes for self-government or independence and to determine their own political future.

* * * * *

ARTICLE VI – REVENUE AND TAXATION

Article VI deals with a variety of revenue and taxation provisions, including provisions relating to customs and excise taxes, as well as social security benefits and other matters.

Section 601. This Section deals with the application of the federal income tax laws.

Subsection (a) states that the federal income tax laws of the United States will come into force in the Northern Marianas as a local territorial income tax on the first day of January following the establishment of the new Government of the Northern Marianas. Prior to that time the income tax laws of the Trust Territory, as modified by the local legislature pursuant to its authority, will be applicable, though after separate administration is accomplished the income taxes will be paid to the local Northern Marianas Government.

Under Subsection (a) the federal income tax laws will apply as a local territorial income tax in the same manner as those laws are enforced in Guam. This

system is a sound one and it apparently works well in Guam. Certain problems which had plagued the operation of the federal tax law as a local tax law – called the "mirror image system" – in Guam have now been solved. This is desirable that Guam and the Northern Marianas have coordinated tax laws since they operate in the same economic and geographic sphere.

The operation of the federal income tax laws in the Northern Marianas under this Subsection can be summarized as follows. Northern Marianas income taxes will be determined not by applying the United States income tax laws, but by substituting the words "Northern Marianas" for the words "United States" wherever they appear in the Internal Revenue Code. These taxes will generally be paid to the Government of the Northern Marianas and will be administered and enforced by the local Government.

Given the general level of incomes in the Northern Marianas, it appears very likely that for a number of years the impact of the federal tax code as a local territorial income tax will not be significant. Moreover, as is noted under Section 602, the Government of the Northern Marianas will have the complete authority to rebate taxes received by it under the local territorial income tax based on income derived from the Northern Marianas (which will be virtually all income for almost all persons here), and so can adjust the impact of the tax to suit local conditions. Moreover, the Government of the Northern Marianas will, as noted under Section 602, have the authority to impose additional local taxes which are needed.

The people of the Marianas currently pay approximately $2.5 million in Trust Territory income taxes. Within a year these taxes probably will increase to more than $3.0 million as a result of increases in Marianas incomes. While U. S. tax rates are much higher than Trust Territory tax rates, it is not likely that the total tax burden of the people of the Marianas will be increased by the application of the federal tax laws. The U. S. income tax is progressive and only people with very large incomes pay significant taxes.

* * * * *

Section 601 of the Covenant does not make the federal unemployment tax or benefits derived therefrom applicable to the Northern Marianas. These laws are not applicable to Guam either. It appears preferable for the Northern Marianas to provide its own unemployment benefits and an appropriate level of taxation to support those benefits, rather than to participate in the federal unemployment tax system and be subject to its high tax rates.

Subsection (b) of this Section assures that persons who are residents of the Northern Marianas will file only one income tax return. This is a desirable simplification which results from the application of the federal income tax laws as a local territorial tax. Under Section 935 of the Internal Revenue Code the income tax return will be filed with only one jurisdiction, Guam, United States or the Northern Marianas, depending on the taxpayer's residence at the end of the taxable year. The taxpayer's entire tax liability is discharged by paying a single tax to the

jurisdiction where the return is filed.

Subsection (c) provides that references in the Internal Revenue Code to Guam will be deemed to also refer to the Northern Marianas, where not otherwise distinctly expressed or manifestly incompatible with the intent of such sections or of the Covenant. This assures that the benefits which are available to Guam under the Internal Revenue Code will also be available to the Northern Marianas. For example, under 26 U.S.C. §7653(b) articles which are shipped from the United States to Guam are free of certain federal excise taxes. This has the effect of making such articles cheaper to purchase in Guam than in other locations. The same will be true in the Northern Marianas.

Section 602. This Section explains in detail the authority of the Government of the Northern Marianas to impose taxes and rebate taxes it received. It states that the Government of the Northern Marianas may by local law impose taxes in addition to those imposed by the local territorial income tax under Section 602. This will be a matter entirely for the local government to determine. Such taxes could include sales taxes or property taxes or taxes on particular commercial or other transactions.

In addition, Section 602 provides that the Government of the NOrthern [sic] Marianas may rebate any taxes received by it, except those taxes received by it under the local territorial income tax which were derived from income from sources outside the Northern Mariana Islands. The local government will not be able to rebate, but will instead have to expend, income taxes it receives under the local

territorial income tax derived from sources outside the Northern Marianas. This is similar to the power which Guam has with respect to its local territorial income tax. The power to rebate taxes will mean that the Northern Mariana Islands Government can adjust the impact of the local territorial income tax in any way which it deems appropriate to the local conditions in the Northern Marianas. In effect, it means that the Northern Marianas Government will have complete authority to write its own tax code. For example, it appears that in Guam rebates are given on income taxes collected from Guam businesses so as to encourage the development of new businesses and new jobs. This could be done in the Northern Marianas as well if the local government wishes. Rebates could also be given to individuals. It should be noted that the local government has the explicit authority to rebate <u>any</u> taxes received by it, so it can rebate taxes which are collected by the Federal government but transferred to the local government pursuant to Section 703(b).

No. 09-870

IN THE

Supreme Court of the United States

AMANDA ARMSTRONG; HUI MIN ZHAO;
XIU ZHEN QI: MEN LIAN CHEN;
EDWARD LIEBERMAN; JOHN DOES,
Petitioner,

v.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS; DEPARTMENT OF FINANCE,
Respondent,

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR THE COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS IN OPPOSITION

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IN THE

Supreme Court of the United States

No. 09-870

AMANDA ARMSTRONG; HUI MIN ZHAO;
XIU ZHEN QI: MEN LIAN CHEN;
EDWARD LIEBERMAN; JOHN DOES,
Petitioner,

v.

COMMONWEALTH OF THE NORTHERN MARIANA
ISLANDS; DEPARTMENT OF FINANCE,
Respondent,

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR THE COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS IN OPPOSITION

ARGUMENT

The specific issues presented by Petitioner are:

1. Whether the Ninth Circuit err when it failed to find that the Northern Mariana Islands Territorial was federal law and thus associated local legislation and agency actions would raise federal questions;

2. Did the Ninth Circuit err when it failed to establish federal jurisdiction from the Covenant phrase "in the same manner as those laws are in force in Guam;"and

3. Did the Ninth Circuit err when it held that the CNMI legislature had authority to require that all disputes arising under the administration of the CNMI Mirror code must be brought exclusively in the CNMI Superior Court?

In support of these issues, eight arguments are presented:

1. The NMTIT is not federal law.

2. Decision in *Holmes v. Dir of Revenue & Taxation* does not support extension of federal jurisdiction in regards to NMTIT issues.

3. Prior extension of federal jurisdiction in Guam tax issues does not provide precedence for similar extension in the CNMI.

4. Decisions of Federal and Third Circuit regarding federal jurisdiction regarding insular area taxation does not support similar federal extension to the CNMI.

5. Covenant language stating that the tax structure is to be implemented "in the same manner as Guam" does not act to extend federal subject matter jurisdiction to CNMI tax issues.

6. The decision in *Olopai v. DeLeon Guerrero* and federal statutory language does not establish the Commonwealth's income tax rebate structure as based on federal law.

7. The Ninth Circuit opinion did not create a wholly local tax system not subject to federal review.

8. The Ninth Circuit decision in this case creates an unintended tax haven.

These arguments do not act to extend federal subject matter jurisdiction, and are examined in the sections that follow.

1. The NMTIT is not federal law

The first argument presented is that the NMTIT is federal law. In support of this position, the holding in *Preece v. Comm'r* and Commonwealth resident tax filing requirements are cited as authority. *Preece v. Comm'r*, 95 T.C. 594 (1990).

In *Preece,* the court examined whether residency in the Commonwealth for tax purposes was to be determined using a facts and circumstances test or substantial presence test. 95 T.C. at 594. The holding in *Preece* was that a facts and circumstances test, as established in federal regulations, was to be used. 95 T.C. at 609.

In support of the assertion that the Northern Mariana Territorial Income Tax (NMTIT) is federal law, Petitioner states that the court in *Preece*, "held that in accordance with I.R.C. § 935, as adopted by Covenant section 601(b), the CNMI Mirror code is federal law, not local law." Pet. App. 11. However, this is a misrepresentation, as the court in *Preece* made no such holding. 95 T.C. at 609-610. Additionally, the citation to authority in support of this position concerns unrelated factual background material and includes no discussion of whether the NMTIT is

federal or local law. Pet App. 11 (citation to 95 T.C. at 595).

Section 601 of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America, Pub. L. 94-241, Act of Mar. 24, 1976; (reprinted at 48 U.S.C. § 1801 note), specifies that the appli cable United States Internal Revenue Code (IRC) provisions be enforced as *local* territorial laws (Covenant.) Pet. App. 44a (Ninth Circuit decision).

2. Decision in *Holmes v. Dir of Revenue & Taxation* does not support extension of federal jurisdiction in regards to NMTIT issues

The second argument of Petitioner is that the Ninth Circuit's decision declining to extend federal jurisdiction to Commonwealth tax claims conflicts with the previous decision rendered in *Holmes v. Dir. of Revenue & Taxation*, 827 F.2d 1243 (9th Cir. 1987). However, this argument indicates a misunderstanding of the decision of *Holmes*.

In Holmes, the court was considering the use of losses from a CNMI subchapter S corporation by Guam residents. 827 F.2d at 1243. In order to clarify application of the NMTIT subchapter S requirements to Guam taxpayers, the court applied the identical term substation guidelines contained in the Organic Act and the Covenant that are used to transform the language of the United States Internal Revenue Code (IRC) to a territorial income tax code. 4 CMC § 1701(e) (CNMI substitution of terms); 48 U.S.C. § 1421i(e) (Guam substitution of terms). Both of these standards provide for the substitution of various key terms in the IRC in order to transform it

from a United States statute to that of the respective territory (e.g. substitute the term "Guam" for "United States"). This structure for the conversion of the IRC to a territorial income tax structure by the use of substituted key terms is commonly referred to as the "mirror code." 827 F.2d at 1245.

Applying these standards, the court examined whether for purposes of applying the NMTIT, the commonwealth corporation would qualify for subchapter S election. 26 U.S.C. 1361(b). Upon determining that under the NMTIT Guam residents would not be considered nonresident aliens and a CNMI corporation would be considered domestic, the court determined that the subchapter S election was proper. 827 F.2d at 1245.[1,2]

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[1] In order to qualify for s corporation election, a corporation had to be a domestic corporation which does not have more than 75 shareholders; a shareholder who is not an individual; a nonresident alien shareholder; or more than one class of stock. 26 U.S.C. 1361(b).

[2] In applying the mirror code provisions of Guam and the CNMI, the court in Holmes developed a novel interpretation. Interpreting the language of Covenant section 601(c) which states "references in the Internal Revenue Code to Guam will be deemed also to refer to the Northern Mariana Islands" they determined that this meant that whenever the term Guam is used in the code it would *include* the term CNMI (*i.e.*, "Guam and CNMI") 827 F.2d 1245 (emphasis added). This approach is contrary to the provisions of both the CNMI and Guam which state that there should be a "substitution" not "addition." 4 CMC § 1701(e). Substitution more appropriately reflects the distinct taxing authority and legal structures of the two entities. However, in *Holmes*, the court properly states that the purpose of the mirror code provisions is to provide flexibility to avoid results that are absurd on their face or that lead to internal contradictions in the application of the Organic Code or Covenant. 827 F.2d at 1246.

In reaching this conclusion, the court decided to use an IRC mirror code interpretation standard in which wherever the term "Guam" was to be inserted, the term "CNMI" was also included. 827 F.2d at 1245. The court stated that this structure allowed for Guam residents to take advantage of the subchapter S structure of CNMI corporations and was not manifestly incompatible with the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America or the Guam Organic Code. 827 F.2d at 1245.

The decision in Holmes does not conflict with the Ninth Circuit's decision in Armstrong, or present substantial questions of federal law. Armstrong states that the Ninth Circuit decision precluding federal jurisdiction conflicts with the holding in Holmes that treated Guam and the CNMI as a common geographic entity. Pet. App. 13. However, these are distinct issues. In Holmes, the court was examining the tax liability of a Guam taxpayer and this required interpreting Commonwealth law. The court in Holmes was not extending jurisdiction over the CNMI. 827 F.2d at 1245. When the courts are applying the mirror code, flexibility is provided due to the complexity of the required manipulation of terms. 827 F.2d at 1245. The court felt that denial of the benefits provided by use of a CNMI subchapter S corporation did not undermine the distinct structure of these tax systems. 827 F.2d at 1245. However, the decision in Holmes was limited to a determination of the tax liability of a Guam resident for which United States law provides subject matter jurisdiction. 48 U.S.C. § 1421i(h). The decision in Holmes does not conflict with the decision of the Ninth Circuit which concerned establishment of Commonwealth Superior Court jurisdiction for the NMTIT.

3. The Ninth Circuit opinion does not conflict with its prior precedents holding that the federal courts have jurisdiction over matters arising out of the administration and enforcement of the Guam Mirror Code without a specific grant from Congress.

In support of the argument that subject matter jurisdiction to hear cases arising under the Guam Territorial Income Tax cases without a specific grant of authority from Congress, Armstrong cites the four cases of: *Laguana v. Ansell*, 102 F. Supp 919 (D. Guam 1952) *aff'd* by 212 F.2d 207 (9th Cir. 1954); *Holbrook v. Tuitano*, 125 F. Sup. 14 (D. Guam 1954); *Wilson v. Kennedy*, 123 F. Supp. 156 (D. Guam 1954), *aff'd* by 232 F.2d 153 (9th Cir. 1956); *Jennings v. United States*, 168 F.Supp. 781 (Fed. Ct. Cl. 1958). However, none of these cases discuss the jurisdiction of the District Court; and the subject matter jurisdiction of each one of these cases is established by United States law. All four of these cases involved federal courts interpreting Guam tax law.[3] 102 F.Supp. at 919; 125 F.Supp. at 14; 123 F.Supp. at 156; 168 F.Supp. at 781. In each case, federal subject matter jurisdiction is expressly provided by United States law. 48 U.S.C. § 1421i(h).

The Guam District Court was established under United States law with the adoption of the Guam Organic Act. 48 U.S.C. §1424(a)(1) (establishment of District Court of Guam); 48 U.S.C. § 1424(b)

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[3] The only jurisdictional issue discussed in the four case cited by Armstrong was the examination of the use of a three-judge panel to examine constitutionality of section 31 of the Organic Act. *Holbrook v. Taitano*, 125 F.Supp. 14, 17 (D.C. Guam 1954).

(District Court shall have broad original jurisdiction). The District Court of Guam was created under Article IV, § 3 of the United States Constitution rather than under Article III and was vested with broad original subject matter jurisdiction as identified in section 22 of the Guam Organic Act to provide initial legal structure for the territory. *Territory of Guam v. Olsen*, 431 U.S. 195, 196 (1977); 48 U.S.C. § 1424(b); 48 U.S.C. § 1424(c). As local courts were established, the United States allowed for a shifting of jurisdiction of the Guam District Court. 48 U.S.C. §1424(c). However, the United States Congress specifically confined subject matter jurisdiction in regards to civil and criminal matters associated with the Guam Territorial Income Tax to the Guam District Court. 48 U.S.C. § 1421i(h)(1); 48 U.S.C. § 1421i(h)(5); 431 U.S. at 197 (subject matter jurisdiction involving the Guam Territorial Tax has always been with the District Ct.).

Armstrong's citation to *Wilson* changes the nature of the argument presented from subject matter jurisdiction to the nature of the Guam Territorial Tax. Pet. App. 14-15. The specific language cited in *Wilson* concerns the interrelationship between the United States and Guam in the implementation of the United States tax laws. Pet. App. 14-15; 123 F.Supp at 159. In this cited section, the *Wilson* court is discussing how the income tax laws of the United States are adopted as local Territorial income taxes. 123 F.Supp at 159. The specific nature of the territorial tax depends on the legal structure used in its implementation and is different in each insular area. In Guam, reflective of its history as a United States Possession, the imposition of the Territorial Income Tax is done completely under United States law although this law provides authority for collection by

the local government. 48 U.S.C. § 1421i (establishment of Guam Territorial Income Tax); 48 U.S.C. § 1421i(c) (establishment of local administration); 48 U.S.C. § 1421i(e) mirror code provisions); 48 U.S.C. § 1421i(h) (jurisdiction of District Court for tax issues); 48 U.S.C. § 1421i(h)(5) (limits transfer of tax jurisdiction). In contrast, in the Commonwealth the agreement to establish the United States income tax is established in the Covenant, but is implemented exclusively through local law. Covenant, Art. VI, § 601(a)-(c); 4 CMC § 1701 (a) (IRC adopted as NMTIT), 4 CMC § 1701(e) (mirror code provisions); 4 CMC § 1702 (adoption of IRC).

It is not contested, that in both Guam and the CNMI the United States Internal Revenue Code has been adopted in such a manner that any changes to the IRC are automatically adopted by the respective insular areas. Furthermore, all of the insular areas are limited in the changes they can make to the Internal Revenue Code. *Government of Guam v. Koster*, 362 F.2d 248, 251 (9th Cir. 1966) (limits on changes to I.R.C.); *Chase Manhattan Bank, NA v. Government of the Virgin Islands*, 300 F.3d 320, 322 (3rd Cir. 2002) (limits on changes to I.R.C.). However, the method provided for adoption of the IRC can directly control its subject matter jurisdiction and this was reflected in the decision of the Ninth Circuit. In the CNMI, the Commonwealth specifically required that the IRC be adopted as a local territorial income tax subject to local court jurisdiction and this is reflected in its legal structure.

Contrary to the third argument of Armstrong, there is no conflict with the decision of the Ninth Circuit and cases deciding administration and enforcement of the Guam Territorial Income Tax.

4. The Ninth Circuit's decision holding the CNMI Mirror code to be adopted under the authority of the local possession does not conflict with decisions from the Third and Federal Circuit's holding that federal law is the source of authority for the Mirror code systems

Armstrong's argument that the Ninth Circuit's decision contradicts decisions of the Third and Federal Circuit indicates a misunderstanding of the legal structures of the Territories of Guam and the United States Virgin Islands.

In support of this position, Armstrong cites the three Third Circuit decisions of: *Chicago Bridge and Iron Company v. Wheatly*, 430 F.2d 973 (3rd Cir. 1970); *HMW Industries, Inc v. Wheatley*, 504 F.2d 146 (3rd Cir. 1974); and *Vitco v. Government of the Virgin Islands*, 560 F.2d 180 (3rd Cir. 1977). Armstrong states that the decisions in these cases show that there is "no ambiguity as to whether matters arising the Virgin Islands territorial income are matters of federal law supporting federal questions subject matter jurisdiction in the district court of the possession." Pet. App. 16. However, federal subject matter jurisdiction for causes arising under the Virgin Islands Territorial Income Tax has never been questioned, as it is specifically addressed in United States law. 48 U.S.C. § 1612. Under the Revised Organic Act of the Virgin Islands, the District Court of the Virgin Islands "shall have exclusive jurisdiction over all criminal and civil proceedings in the Virgin Islands with respect to the income tax laws applicable to the Virgin Islands."

Armstrong's argument that the Federal Circuit decision of *Bank of Guam v United States*, 578 F.3d 1318 (Fed. Cir. 2009) is in conflict with the decision of the Ninth Circuit is not clear. Armstrong states that the holding in *Bank of Guam* is that Guam merely "administers the income tax laws of the United States at the direction of the United States and not the possession or territory." Pet. App 17. Armstrong uses the holding in *Bank of Guam* to support the position that "federal law is the source of authority for the [m]irror [c]ode systems" and that this conflicts with the decision of the Ninth Circuit. Pet. App.17.

However, this argument misunderstands the holding of the Ninth Circuit. Like the statements made by the court in *Bank of Guam*, the Ninth Circuit decision recognized that the United States income tax laws were the foundation for the NMTIT. Pet. App. 36a. However, the Ninth Circuit distinguished the tax structures of Guam and the CNMI by the legal structures used in the adoption of the respective income tax systems. Pet. App. 43a-45a.

In Guam, the territorial income tax structure is established completely under United States law. The mirror code system, administrative structure, and subject matter jurisdiction are all established under United States law. 48 U.S.C. § 1421i(a); 48 U.S.C. § 1421i(b) (establishment of Guam Territorial Income Tax); 48 U.S.C. § 1421i(c) (administration of Guam Territorial Income Tax); 48 U.S.C. § 1421i(e) (mirror code structure); 48 U.S.C. § 1421i(h) (exclusive subject matter jurisdiction of District Court of Guam). Under this structure, the Guam Territorial Income Tax is controlled by United States law, and specific statutory language retained exclusive subject matter jurisdiction within the federal court. 48 U.S.C.

§ 1421i(h) (exclusive subject matter jurisdiction of District Court of Guam).

In contrast, the Commonwealth of the Northern Mariana Islands has established the structure of the territorial income tax under Commonwealth law as provided for by the Covenant. 4 CMC § 1701(a) (adoption of United States Internal Revenue Code as the Northern Marianas Territorial Income Tax); (b) (administration and enforcement of the NMTIT); (c) (authority of the Governor); (e) (establishment of mirror code system). Subject matter jurisdiction for all causes arising under the NMTIT is specifically established by Commonwealth law in the Superior Court of the Northern Mariana Islands. 4 CMC § 1701(e). Using the authority provided in the Covenant, the Commonwealth established the NMTIT as a local law, and retained subject matter jurisdiction within its courts.

The holdings of the Third and Federal Circuit cited by Armstrong are consistent with the decision in the Ninth Circuit. The differences in these holdings reflect the different legal structures provided for the territorial income tax structures of Guam, the United States Virgin Islands, and the CNMI.

5. Covenant Section 601's directive that the Mirror code system in the CNMI will be "in force" in the "same manner as Guam" does not extend subject matter jurisdiction to the CNMI district court

Armstrong's fifth argument in support of the position that the Ninth Circuit position was in error is that the meaning of the Covenant section 601(a) phrase "in force . . . in the same manner as those laws are in force in Guam," extends subject matter jurisdiction to the CNMI district court.

The issue of the meaning of the phrase referring to how the territorial income tax is enforced in Guam is a reoccurring issue. Since the Covenant is a United States Statute, it is appropriate that standards of statutory interpretation be used to clarify its meaning. 48 U.S.C. § 1801 note. Statutory interpretation requires that one must first examine the plain meaning of the language used and absent a clearly expressed legislative intent to the contrary, that language must be regarded as conclusive. *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). In expounding a statute, you are not guided by a single sentence or member of a sentence, but look to the provisions of the whole law, its objective, and policy. *United States National Bank of Oregon v. Independent Insurance Agents of America, Inc.*, 508 U.S. 439, 455 (1993). Plainness or ambiguity of statutory language is determined by reference to: the language used; specific context in which language is used; and the broader context of the statute as a whole. *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997).

To determine the meaning of the statutory phrase "same manner as those laws are in force in Guam," we look to the plain meaning of the words used, its context and objective. *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980); *United States National Bank of Oregon v. Independent Insurance Agents of America, Inc.*, 508 U.S. 439, 455 (1993). The statutory phrase referring to Guam concerns adoption of the United States Internal Revenue Code as a Northern Mariana Territorial Income Tax. Covenant, Art. VI § 601. In order to accomplish the objective of converting a United States tax structure to a local territorial tax requires that certain terms be substituted to bring these laws

"into force in the Northern Mariana Islands as a local territorial income tax." Covenant, Art. VI § 601(a). The territory of Guam used a substitution of terms to bring their income tax structure "*in force in Guam.*" 48 U.S.C. § 1421i(e) (substitution of terms)(emphasis added). "In the same manner as [these] laws are in force in Guam," the Commonwealth adopted a plan for the substitution of terms. 4 CMC § 1701(e). Under the terms of this structure:

> (e) In applying the NMTIT for any purpose contained within this division, except where it is manifestly otherwise required, the applicable provisions of the I.R.C. shall be read so as to substitute Commonwealth of the Northern Mariana Islands for United States, Governor or his delegate for Secretary or his delegate, Governor or his delegate for Commissioner of Internal Revenue and Collector of Internal Revenue, Superior Court of the Northern Mariana Islands for district court, Supreme Court of the Northern Mariana Islands for United States Courts of Appeal, Attorney General for district counsel, Attorney Generals Office for Department of Justice, and with other changes in nomenclature and other language, including the omission of inapplicable language, where necessary to effect the intent of this chapter.

4 CMC § 1701(e). The plain meaning of the phrase, "*as those laws are in force in Guam*," when examined in terms of its context and policy objective supports a finding that this refers to implementation of a substitution of terms structure that would allow "[t]he income tax laws *in force* in the United States [to] come *into force* in the Northern Mariana Islands as a local territorial income tax . . . in the same

manner as those laws are *in force* in Guam." Covenant Art. VI § 601 (emphasis added).

In contrast to the use of statutory standards of interpretation to determine the meaning of the phrase "in force . . . in the same manner as those laws are in force in Guam," Armstrong relies on a combination of five different extrinsic aids: 1) contemporary analysis; 2) 1983 Congressional report; 1985 federal commission findings; and 5) case law. Pet. App. 19-21. The documents cited by Armstrong agree that the phrase at issue refers to use of the mirror code structure to transform the United States Internal Revenue Code to a territorial income tax structure.[4] The one document provided by Armstrong that addresses the issue of subject matter jurisdiction is a 1985 study produced by the Northern Mariana Island Commission on Federal Law to the Congress of the United States (hereinafter "Commission Study). *Welcoming America's Newest Commonwealth-The Second Interim Report of the Northern Mariana Islands Commission on Federal Laws to the Congress of the United States* (August 1985). Pet. App. 20. This document states, "[t]he District Court for the Northern Mariana Islands has civil and criminal

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[4] The first document cited by Armstrong, The *Section by Section Analysis of the Covenant to Establish a Commonwealth of the Northern Mariana Islands*, was prepared by the Marianas Political Status Commission in 1975 and is generally considered as a valid source for interpretation of the Covenant. This analysis agrees that the phrase "into force . . . in the same manner as those laws are in force in Guam," references the mirror code structure. *Section by Section Analysis of the Covenant to establish a Commonwealth of the Northern Mariana Islands,* 67-68 (Marianas Political Status Commission 1975) (hereinafter "Covenant Analysis"). However, the issue of subject matter jurisdiction over tax issues is not discussed.

jurisdiction over disputes involving the local territorial income taxes of the Northern Mariana Islands" Commission Study at 436; Pet. App. 20. The shortcoming of this source is that it cites Guam law for authority. Citation to Guam law is improper when controlling law is established by the Commonwealth. During the period from January 1, 1985 through January 1, 1995, the Commonwealth provided the District Court of the Northern Mariana Islands with subject matter jurisdiction over Northern Mariana Territorial Income Tax matters. CNMI P.L. 4-24 (provides subject matter jurisdiction for tax to District Court); P.L. 9-22 (transfers subject matter jurisdiction for the NMTIT from District Court to CNMI Superior Court). Citation to invalid authority undermines Armstrong's argument that subject matter jurisdiction is vested in the District Court of the Mariana Islands.[5] Pet. App. 20.

Thus, the documents Armstrong cites, are in agreement with the plain meaning interpretation of this statutory phrase, "in force . . . in the same manner as those laws are in force in Guam" implies application of the mirror code. Covenant Art. VI, § 601(a). Commonwealth law provided the structure for application of the mirror code and this dictates that subject matter jurisdiction for tax issues in the Northern Mariana Islands Superior Court. 4 CMC § 1701(e). Armstrong's sole reference to District

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[5] Armstrong cites the holding in the case of *Preece v. Comm'r* for the position that the court, "clearly employed the analysis as what the Covenant Section 601 meant by the phrase "same as Guam." Pet. App. 20; 95 T.C. 594. However, in *Preece*, the only reference to the phrase "same as Guam" is a brief discussion stating that in interpreting section 601(a) of the Covenant, one should substitute the word CNMI for the United States where appropriate. 95 T.C. at 598.

Court jurisdiction over tax claims is based on improper authority.

6. Ninth Circuit panel did not misquote the District Court in another case that arose under 48 U.S.C. § 1843 (c)

In this sixth argument, Armstrong takes the position that income tax rebates provided by the Commonwealth are authorized by federal law and that violation of these laws provides federal subject matter jurisdiction. Pet. App. 21-23. In support of this position, Armstrong cites the federal statute which requires that the Commonwealth rebate system requires prior payment of taxes. Pet. App. 21; 48 U.S.C. § 1843.

The Commonwealth tax rebate system, like the NMTIT is a combination of federal and local law. Authority to grant rebates from the NMTIT is established in the Covenant which states that this shall be done under "local law." Covenant, Art. VI § 602 (government may provide rebate of any taxes received). Local law establishes taxpayer entitlements to rebates and program structure. 4 CMC § 1708. Thus, like the NMTIT, authority for granting of rebates is provided by the Covenant, but structured to be done through Commonwealth law. Covenant, Art. VI, § 602; 4 CMC § 1708. This is the position identified by the Ninth Circuit.

Armstrong argues that this position conflicts with the congressional intent in the adoption of 48 U.S.C. § 1843[6] and the decision in *Olopai v. DeLeon*

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[6] Armstrong's citation to authority (note 23) is incorrect. The proper citation should be to 129 Cong. Rec. H7861 (daily ed. October 3, 1983).

Guerrero, 1993 U.S. Dist Lexis 13839 (D.N.Mar.I. Sept 24, 1993); Pet. App. 21-23. These two issues are examined below.

Armstrong's first issue in her sixth argument concerns statements made by the court in *Olopai v. De Leon Guerrero*, 193 U.S. Dist. LEXIS13839 (D.N. Mar. I. Sept.. 24 1993) (hereinafter *Olopai*). Pet. App. 22. In this argument, Armstrong states that the "Ninth Circuit misquotes *Olopai*." Pet. App. 22. However, the Ninth Circuit decision only cited *Olopai* for the provision of background information regarding the tax structure of the CNMI. Pet. App. 36a, 41a. In contradiction to her argument, Armstrong does not contest the background citations to *Olopai* provided by the Ninth Circuit, and instead goes on at length concerning issues in *Olopai* that were not cited. Pet. App. 22.

The specific section of *Olopai* cited by Armstrong in this new argument concerns whether the disclosure provisions of P.L. 98-213 violate the Covenant. Pet. App. 22.[7] P.L. 98-213 concerned United States law which required public disclosure of rebate information. *Olopai* at 1. The position of the CNMI was that under section 602 of the Covenant, rebates were to be controlled by local law and thus any federal requirements were an infringement of the right to self-government established by Covenant sections 103 (self-government) and 105 (mutual consent). *Olopai*, at 12. The court stated that under terms of sections 101 (U.S. sovereignty) and 102 (supremacy clause) the United States had authority to enact

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[7] Armstrong's citation to the appropriate section in *Olopai* (*i.e.*, *Olopai* at 10) is in error as the cited section should read, *Olopai* at 11.

appropriate legislation. *Olopai,* at 12. However, in order to determine if U.S. legislation improperly infringed on the right to self-government, a test was required which balanced the interest of the United States in monitoring the Commonwealth's use of the local rebate structure against the degree of intrusion in local affairs. *Olopai,* at 12. The court found that the federal interest in monitoring this local rebate program was significant and the intrusion on self-government was appropriate and justified. *Olopai*, at 12-13.

Armstrong's use of the discussion of the *Olopai* court's discussion of U.S. sovereignty and the supremacy clause as contained in the Covenant are unclear. The Ninth Circuit decision is consistent with the holding in *Olopai* in that the United States and the Commonwealth each have their respective areas of responsibility in the implementation of the tax structure. The Ninth Circuit decision does not conflict with the *Olopai.*

Armstrong's final sixth argument component concerns the legislative history surrounding the adoption of 48 U.S.C. § 1843. Pet App. 23. This United States statute concerns initial implementtation of the NMTIT. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). Congress had initially requested an implementation of the NMTIT by January 1, 1979. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). However, Commonwealth residents were concerned about the new pending tax liability and local legislators proposed that the rebate system be structured to be a tax abatement system where tax liability associated with Commonwealth source income would be abated instead of rebated. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). In an abatement structure, the tax

liability was waived without payment. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). In a rebate structure, tax liability had to be paid prior to return (rebate) by the government. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). The United States felt that an abatement system would undermine the United States Internal Revenue Code Structure, and in subsequent negotiations, the Commonwealth agreed to maintain a rebate structure. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). This negotiated transition plan provided for a waiver of tax liability on Commonwealth source income for the first three years of implementation of the NMTIT. Due to the limited ability of the Commonwealth to amend the substantive provisions of the IRC, this waiver had to be provided by United States law. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). This United States transition program also restricted the use of the authorized rebate program by providing a definition that precluded abatement. 48 U.S.C. 1843(c).

Contrary to the argument of Armstrong, the legislative history illustrates the mixture, and limits, of United States and Commonwealth law. Under United States law, the tax structure is provided, however Commonwealth law is used to implement, enforce and establish tax liability. Covenant; Art. VI § 601; 4 CMC § 1701(a)-(e). This legislative history is consistent with the Ninth Circuit's decision.

7. The Ninth Circuit opinion did not create a wholly local tax system not subject to federal review

The seventh argument raised by Armstrong in support of extension of federal subject matter jurisdiction over NMTIT issues is based on the assertion that "[t]he Ninth Circuit's opinion permits the CNMI to have a wholly local tax system not subject to federal review without going through the process that Congress requires for Mirror code possessions to delink." Pet. App 24. This argument is based on federal law that was adopted in 1986 which allows territorial governments to be excluded from use of the United States Internal Revenue Code by adoption of alternative tax structures.[8] Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986, H.R. 3833, 99th Congress, P.L. 99-514 (hereinafter "Joint Committee").

This legislation had several objectives. It was recognized that the imposition of the complex United States income tax structure on small undeveloped isolated communities posed a significant burden. Joint Committee at 118. Additionally, the ever changing tax laws overwhelmed island tax officials. Joint Committee at 118. Furthermore, the United States tax structure was inappropriate for communities with high proportion of lower income individuals. Joint Committee at 118. Finally, it was felt that island tax structure had to be more responsive to

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[8] The provision of alternative tax structures to the United States Internal Revenue Code for the Insular areas was based on the difficulty of administering this complex tax structure by governments with extremely limited resources. Joint Committee at 1118.

the particular economic needs of the community. Joint Committee at 118.

Although the United States understood the problems associated with use of the IRC in small communities, it had concerns that by eliminating its use would create tax havens. Joint Committee at 118. In order to address this concern, the United States coupled the authority to drop the required use of the Internal Revenue Code with significant oversight and alternative requirements. Joint Committee at 118. These requirements varied by each insular area, but generally included increased monitoring by the United States, maintenance of revenues, and coordination with U.S. tax policies. The limited resources of the insular area tax authorities and apprehension about changing from an accepted United States standard have prevented any of the insular areas from implementing these alternative tax structures.

Armstrong's argument regarding the alternative tax structures contained in the Tax Reform Act of 1968 are unclear. It is assumed that the Armstrong argument is that by prohibiting federal subject matter jurisdiction, the Ninth Circuit has created an alternative tax structure in the Commonwealth in violation of the requirements of the Tax Reform Act of 1968. App. Pet. 24. However, this is an unsubstantiated claim totally unsupported by facts.

The Commonwealth coordinates its tax structure and administration with the United States Internal Revenue Service. 4 CMC § 1701 through 4 CMC § 1713. All Commonwealth taxpayers are required by law to fully comply with all applicable elements of the United States Internal Revenue Code adopted by the NMTIT. 4 CMC § 1701 through 4 CMC § 1713.

The CNMI uses the same forms, procedures, and legal structure of the United States Internal Revenue Code. 4 CMC § 1701 though 4 CMC § 1713. Additionally, the Commonwealth has adopted the same criminal and civil penalty structure of the United States and actively places liens and levies on delinquent taxpayers.

The Commonwealth tax structure is subject to numerous limits and reviews to ensure the coordination of Commonwealth and United States tax systems. These limits include: residency requirements; special sourcing rules; and taxpayer information exchanges. 26 U.S.C. § 935; 26 CFR §§ 1.931-1 through 1.937-3 (special sourcing rules). These special Internal Revenue Regulations all act to restrict and control the application of the United States tax laws in the Commonwealth. Additionally, the Commonwealth adheres to the limitation that it may only make changes in the Internal Revenue Code that are required to address items that are manifestly incompatible with the intent of the specific section of the Internal Revenue Code. 4 CMC § 1701(h); *Government of Guam v. Koster*, 362 F.2d 248, 251 (9th Cir. 1966) (limits on changes to I.R.C.); *Chase Manhattan Bank, NA v. Government of the Virgin Islands*, 300 F.3d 320, 322 (3rd Cir. 2002) (limits on changes to I.R.C.)

Armstrong's claim that the decision of the Ninth Circuit has created an unregulated tax haven in the CNMI conflicts with the ongoing administration and enforcement of the NMTIT, and is without merit.

8. The Ninth Circuit's Decision in this Case creates an unintended tax haven

In Armstrong's final argument it is asserted that the Ninth Circuit's decision will lead the creation of a U.S. tax haven in the Commonwealth. This argument is similar to that asserted in argument seven and should be similarly dismissed.

Armstrong's assertion that the Commonwealth will become a tax haven is made without factual or legal support. Furthermore, many of the claims made by Armstrong are incorrect. First, Armstrong's claim concerning rebates fails to identify that only Commonwealth source income is subject to rebates. 4 CMC § 1708. Second, there are significant limits on the application of the NMTIT that ensure compliance with the intent of Article VI of the Covenant including residency requirements; sourcing rules; and limits on changes to Internal Revenue Code language. 26 U.S.C. §§ 935 (residency and filing requirements), 26 U.S.C. § 937 (residency); 26 CFR § 1.931-1; through 26 CFR § 1.937-3 (special sourcing rules). Third, the Covenant specifically authorizes the Commonwealth to provide rebates based on Commonwealth sourced income. Covenant art. VI § 602. Fourth, language in the Covenant and the NMTIT specifically limit any changes to the Internal Revenue Code that would alter the intent of the statutes. 4 CMC § 1701(h); *Government of Guam v. Koster*, 362 F.2d 248, 251 (9th Cir. 1966) (limits on changes to I.R.C.); *Chase Manhattan Bank, NA v. Government of the Virgin Islands*, 300 F.3d 320, 322 (3rd Cir. 2002) (limits on changes to I.R.C.). Armstrong's argument that the CNMI has used its authority over the NMTIT to alter the date interest accrues on refunds is incorrect as the statute she

refers to concerns the date for allowance of tax rebate offset. (Pet at 26); 4 CMC § 1711(b) (rebate offset procedure). Fifth, there is no history of the Commonwealth being used as a tax haven; in fact the opposite is true as the Commonwealth and the United States have specifically adopted rules that restrict residency and the associated tax privileges. 26 U.S.C. § 935; 26 U.S.C. § 937; 26 CFR § 1.931-1 through 26 CFR § 1.937-3 (special sourcing rules). Finally, the Commonwealth is an undeveloped small, isolated, community with a high degree of poverty, lack of infrastructure, and small population (under 60,000) dispersed among 14 islands, and there is not a documented need or legal foundation for the extension of federal jurisdiction into this small local tax system.

CONCLUSION

For the reasons cited above, the petition for the writ of certiorari should be denied.

Respectfully submitted.

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IN THE

Supreme Court of the United States

AMANDA ARMSTRONG; HUI MIN ZHAO;
XIU ZHEN QI; MEN LIAN CHEN;
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Petitioners,

v.

COMMONWEALTH OF THE NORTHERN MARIANA
ISLANDS; DEPARTMENT OF FINANCE,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF FOR PETITIONERS

I. SUMMARY OF REPLY

In its opposition brief, respondent Commonwealth of the Northern Mariana Islands ("CNMI") acknowledges that the Ninth Circuit's decision in this case creates an income tax structure in the CNMI that is wholly different from the tax structure in Guam and other U.S. mirror-code possessions. *See, e.g.*, Resp. Br. at 11-12. Although Congress has imposed federal judicial oversight on Guam and other U.S. mirror-code possessions, the CNMI insists—and the Ninth Circuit agreed—that no such federal oversight applies to the mirror-code tax system of the CNMI.

Instead, according to the CNMI and the Ninth Circuit's decision in this case, Congress gave the CNMI a coveted authorization to implement the United States Internal Revenue Code ("IRC") as "a local territorial income tax subject to [exclusive] local court jurisdiction." Resp. Br. at 9; *see also Armstrong et al. v. Commonwealth of the N. Mariana Islands*, 576 F.3d 950, 956-57 (9th Cir. 2009).

Review is warranted because the Ninth Circuit is simply wrong. Nothing in the "Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America," *reprinted in* 48 U.S.C. § 1801 (Note), reflects any congressional authorization for the CNMI to establish a mirror-code tax system that is uniquely exempt from the supervision of the federal courts. The opposite is true. Both the text and the history of the Covenant reflect a strong congressional intent to maintain uniformity among the mirror-code tax systems in general and between the CNMI and Guam in particular. Covenant section 601(a) achieves that goal by a direct statutory reference to the mirror-code tax system in force in Guam, which includes exclusive federal court supervision.[1] The Ninth Circuit's decision allowing the CNMI to execute its mirror-code tax system as a local law subject to exclusive

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[1] *See, e.g.*, Marianas Political Status Commission, Section by Section Analysis of the Covenant to Establish the Commonwealth of the Northern Mariana Islands, *reprinted in* Hearings before the Subcommittee on Territorial and Insular Affairs of the House Committee on Interior and Insular Affairs on H.J. Res. 549 *et al.* to Approve the Covenant to Establish the Northern Mariana Islands, 94th Cong., 1st Sess., 645 (1975) ("It is desirable that Guam and the Northern Marianas have coordinated tax laws since they operate in the same economic and geographic sphere.").

CNMI local court jurisdiction directly conflicts with congressional intent that the income tax system "in force in" the CNMI be implemented "in the same manner as Guam." It also disregards federal precedents recognizing the inherent federal character of the IRC when applied as a local territorial income tax.

Review further is warranted because the Ninth Circuit's decision has far-reaching consequences. In urging this Court to deny review, the CNMI repeatedly offers assurances that federal law constrains the CNMI legislature's authority to modify the IRC as it applies to CNMI residents filing their U.S. income tax returns with the local CNMI tax agency. *See, e.g.*, Resp. Br. at 22-25. At the same time, however, the CNMI vigorously argues that it possesses authority to exclude the federal courts from supervising alleged conflicts between the IRC, on the one hand, and CNMI legislation and administrative and judicial decisions applying the Northern Mariana Territorial Income Tax ("NMTIT"), on the other hand. *See id.* at 11-12. In this case, for example, the CNMI argues and the Ninth Circuit held that only the CNMI territorial courts have subject-matter jurisdiction to review petitioners Armstrong *et al.*'s challenges to the NMTIT's compliance with the IRC and federal legislation restricting the CNMI's grant of income tax rebates.[2] *See id.* at 17; *Armstrong*, 576 F.3d at 956-

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[2] Petitioners' claims for relief are based directly on alleged conflicts with federal law. The conflicts were revealed and documented by the United States Department of the Interior ("DOI") in an auditor's report conducted by Deloitte and Touche, LLP and published by the DOI. *See* Auditor's Report of 2005, Northern Marianas Government Owes over $24 Million in Tax Rebates, *Tax Notes Int'l*, August 28, 2006 (Dec. 2006).

57. In other cases arising from taxpayer returns filed with the CNMI equally or more important issues of federal taxation will be placed beyond federal court review. *See, e.g.*, Resp. Br. at 22-23 (discussing those provisions).

Under Covenant section 403, there is no avenue for federal court review of decisions of the CNMI local territorial courts except by writ of certiorari to this Court for cases involving federal questions. As a result, under the Ninth Circuit's decision, the world-wide U.S. tax liability for CNMI residents will be a local issue largely insulated from federal review. In view of the importance of the issues presented, this Court should grant the petition for a writ of certiorari and reverse the decision below.

II. THE TEXT, CONTEXT, AND LEGISLATIVE HISTORY OF COVENANT SECTION 601(a) REFLECT CONGRESSIONAL INTENT FOR FEDERAL JUDICIAL OVERSIGHT OF THE NMTIT

In urging that Congress intended to create a unique mirror-code tax system in the CNMI, the CNMI—like the Ninth Circuit below—relies solely on the text of section 601(a) of the Covenant. Covenant section 601(a) provides:

> "The income tax laws in force in the United States will come into force in the Northern Mariana Islands as a *local territorial income tax* on the first day of January following the effective date of this Section, *in the same manner as those laws are in force in Guam.*"

48 U.S.C. § 1801 (Note) (Covenant § 601(a) (emphasis added).

Although Covenant section 601(a) appears to prescribe the same mirror-code system as applies to Guam, the CNMI and the Ninth Circuit take a very different view. *See, e.g., Armstrong*, 576 F.3d at 957-56 (interpreting that statute). According to the CNMI, the statutory phrase "in the same manner as those laws are in force in Guam" refers to only the "implementation of a substitution of terms structure" to adopt the IRC as the law of the CNMI. *See* Resp. Br. at 13-14. The CNMI also relies solely on the reference to the enforcement of applicable IRC provisions as a "local" territorial tax to urge that Congress intended to create a different mirror-code system in the CNMI than the mirror-code system applicable to Guam and other U.S. insular territories. *See id.* at 11-12. Neither the plain text of Covenant section 601(a) nor its history supports the CNMI's position.

A. The Wording and Legislative History of Covenant Section 601(a) Establish that Both the NMI and Congress Intended Federal Court Supervision of the NMTIT Just "As Those Laws Are in Force in Guam"

Although the CNMI urges that the statutory phrase "in the same manner as those laws are in force in Guam" refers to only the substitution of terms in Guam's mirror-code system under 48 U.S.C. § 1421i(e), nothing in the text or history of Covenant section 601(a) suggests such a limitation. The text of Covenant section 601(a) prescribes the same mirror-code system for the CNMI as exists in Guam without any qualification. The legislative history of Covenant 601(a)—as well as congressional reports interpreting that provision—confirm that Congress intended for all provisions of the mirror-code system under the

Guam Organic Act, 48 U.S.C. § 1421i, to apply with equal force to the CNMI.

Covenant section 601 was drafted, in substantially the form in which it was enacted by Congress, in the Fifth Round of Covenant Negotiations by the Office for Micronesian Status Negotiations and the Marianas Political Status Commission. The Fifth Round draft submitted to Congress contained a version of Covenant section 601(a) that was identical to the version of Covenant section 601(a) ultimately enacted by Congress, with the omission of one parenthetical. The draft makes clear that the negotiating parties expressly contemplated that the statutory framework for applying the IRC to Guam—including exclusive federal court jurisdiction over all disputes involving Guam's territorial income tax—would apply equally in the CNMI.

The Fifth Round draft of section 601(a) recited:

> "The income tax laws in force in the United States will come into force in the Northern Mariana Islands as a local territorial income tax on the first day of January following the effective date of this Section, in the same manner as those laws are in force in Guam (*under the provisions of Section 1421i of title 48, United States Code*)."

See Supp. Appendix A at 11a (emphasis added).

That parenthetical shows that the drafters expressly intended for the CNMI's mirror-code system to adopt *all* provisions of Guam's mirror-code system under 48 U.S.C. § 1421i, rather than only the substitution of terms provision under 48 U.S.C. § 1421i(e) as the CNMI contends.

At the time of the Fifth Round of Negotiations—as it does today—48 U.S.C. § 1421i included subparagraphs § 1421i(h)(1) and (2) conferring the U.S. District Court of Guam with exclusive original jurisdiction over all matters arising under the local Guam territorial income tax. Specifically, 48 U.S.C. § 1421i(h) provides, in part:

> (h) Jurisdiction of District Court; suits for recovery or collection of taxes; payment of judgment.
>
> (1) Notwithstanding any provision of section 22 of this Act [48 USCS § 1424] or any other provision of law to the contrary, the District Court of Guam shall have *exclusive original jurisdiction over all judicial proceedings in Guam, both criminal and civil, regardless of the degree of the offense or of the amount involved, with respect to the Guam Territorial income tax.*
>
> (2) Suits for the recovery of any Guam Territorial income tax alleged to have been erroneously or illegally assessed or collected . . . under the income-tax laws in force in Guam . . . may, regardless of the amount of claim, be maintained against the government of Guam . . . in the United States district court with respect to the United States income tax. . . .

(Emphasis added.)

Although Covenant section 601(a) ultimately was adopted without the parenthetical reference to 48 U.S.C. § 1421i, nothing in the legislative history suggests that the deletion of the parenthetical reference intended any substantive change. Indeed, as the CNMI acknowledges (Resp. Br. at 15-16), a subsequent report of the Northern Mariana Islands

Commission on Federal Laws to the U.S. Congress expressly stated that "[t]he District Court for the Northern Mariana Islands has civil and criminal jurisdiction over disputes involving the local territorial income taxes of the Northern Mariana Islands." *See* N. Mariana Islands Comm'n on Fed. Laws, *Welcoming America's Newest Commonwealth*, Second Interim Report of the N. Mariana Islands Comm'n on Fed. Laws to the Congress of the United States, at 436 (August 1985). Although the CNMI discounts the significance of this report by arguing that it "improper[ly]" cited Guam law as support for its jurisdictional statement, the citation to Guam law is consistent with Covenant section 601(a). Covenant section 601(a) expressly provides the CNMI's mirror-code system is to operate "in the same manner as those laws are in force in Guam" and, consequently, the judicial structure for enforcing the mirror code in Guam is the same judicial structure that applies to the CNMI.

B. The Use of the Word "Local" in Covenant Section 601(a) Does Not Reveal Any Congressional Intent for the CNMI Mirror-Code System to Operate Differently than the Guam Mirror-Code System

The CNMI also relies on Covenant section 601(a)'s direction for the IRC to be enforced as a "local" territorial income tax in the CNMI to argue that Congress intended for the CNMI's mirror-code system to operate as a local law subject to the exclusive jurisdiction of CNMI local territorial courts, in contrast to the mirror-code system applicable in Guam. *See*, *e.g.*, Resp. Br. at 4. But the CNMI—like the Ninth Circuit—reads too much into that statutory phrase.

No language in Covenant section 601(a) refers to the CNMI legislature or requires the CNMI legislature to enact the NMTIT. No language in Covenant section 601(a) grants the CNMI legislature any authority to determine the scope or content of the IRC or the jurisdiction of the federal courts. Instead, Covenant section 601(a) simply provides that the IRC "will come into force" as a local territorial income tax just as the IRC came into force in Guam as a local territorial income tax.

The plain meaning of the phrase "will come into force" is clear. Congress imposed the IRC on the CNMI as its local territorial income tax. That application is not dependent on the will or preferences of the CNMI legislature. In the absence of any clear indication of such intent, this Court generally assumes that "Congress when it enacts a statute is not making the application of the federal act dependent on state law." *Jerome v. United States*, 318 U.S. 101, 104 (1943).

To support its contrary construction of this federal statute, the CNMI seeks to distinguish judicial precedents prior to 1958 recognizing the Guam mirror-code system as federal law.[3] The CNMI argues that these cases are inapposite because, according to the CNMI, the jurisdiction of the U.S. District Court of Guam for those cases was granted by 48 U.S.C. § 1421i(h). *See* Resp. Br. at 7-8, 11-12. The CNMI is mistaken. 48 U.S.C. § 1421i was not adopted until 1958, and it was adopted expressly for the purpose of

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[3] Those precedents include *Laguana v. Ansell*, 102 F. Supp. 919 (D. Guam 1952), *Wilson v. Kennedy*, 123 F. Supp 156 (D. Guam 1954), and *Holbrook v. Taitano*, 125 F. Supp. 14 (D. Guam 1954).

ratifying and confirming the prior decisions of the U.S. District Court of Guam and the Ninth Circuit exercising jurisdiction over suits against Guam arising out of the enforcement or administration of the Guam territorial income tax. *See* Supp. Appendix C at 31a.

Finally, the CNMI's and the Ninth Circuit's view of Covenant section 601(a) ignores the fact that federal judicial supervision is an important component of the well-established principle of "uniformity of national taxation." *See, e.g., United States v. Pelzer*, 312 U.S. 399, 402-03 (1941) ("But as we have often had occasion to point out, the revenue laws are to be construed in the light of their general purpose to establish a nationwide scheme of taxation uniform in its application. Hence their provisions are not to be taken as subject to state control or limitation unless the language or necessary implication of the section involved makes its application dependent on state law." (citing *Burnet v. Harmel*, 287 U.S. 103, 110 (1932); *Morgan v Commissioner*, 309 U.S. 78, 81 (1940)). The term "local" in Covenant section 601(a) simply references the undisputed fact that the IRC applies to the CNMI as a local territorial tax just as it does in Guam.

III. IF FEDERAL COURT JURISDICTION IS FORECLOSED BY CNMI LEGISLATION, THERE CAN BE NO FEDERAL REVIEW OF THE CNMI'S ENFORCEMENT AND APPLICATION OF THE INTERNAL REVENUE CODE FOR ALL RESIDENTS OF THE CNMI

The CNMI's opposition to this Court's review protests that so many federal statutes apply, or are intended to apply, to regulate the application of the

IRC in the CNMI that this Court should permit the CNMI legislature to make the conclusive determination that "there is not a documented need or legal foundation for the extension of federal jurisdiction into this small local tax system." Resp. Br. at 9, 22-25. But pervasive regulation of the application of the IRC to the CNMI only supports federal jurisdiction.

There is no federal court review of decisions of the CNMI Superior and Supreme Courts save by writ of certiorari to this Court under Covenant section 403. The CNMI's position, sustained by the Ninth Circuit panel decision below, for all practical purposes limits judicial review over the application and interpretation of the IRC to CNMI residents to the local CNMI courts. Such a limitation has far-reaching implications. If allowed to stand, the Ninth Circuit's decision provides that the CNMI local territorial courts have exclusive authority to control not only decisions respecting locally-sourced income (including the important determination of what is locally-sourced and what is not), as the CNMI contends (Resp. Br. at 24), but all other U.S.-sourced and world-wide income of the CNMI "resident."

CONCLUSION

The plain wording and the history of the negotiation of Covenant section 601(a) establish that the Northern Mariana Islands and the United States bargained for and intended to implement federal judicial supervision of the application of the IRC as the CNMI territorial income tax, contrary to the decision of the Ninth Circuit panel. The strong potential for conflicts between the established policy of national uniformity in the application of the IRC and the unreviewable decisions of the local CNMI courts—along with the potential for resulting tax evasion or avoidance, intentional or not, from the panel's refusal to exercise federal jurisdiction—warrants discretionary review by this Court. For those reasons stated in this brief and in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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SUPPLEMENTAL APPENDIX A

TO APPROVE "THE COVENANT TO ESTABLISH A COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS," AND FOR OTHER PURPOSES

HEARING BEFORE THE SUBCOMMITTEE ON TERRITORIAL AND INSULAR AFFAIRS OF THE COMMITTEE ON INTERIOR AND INSULAR AFFAIRS HOUSE OF REPRESENTATIVES

Ninety-Fourth Congress

First Session

On

H.J. Res. 549, H.J. Res. 550, and H.J. Res. 547

TO APPROVE THE "COVENANT TO ESTABLISH A COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS IN POLITICAL UNION WITH THE UNITED STATES OF AMERICA," AND FOR OTHER PURPOSES

Hearing Held In Washington. D.C.
July 14, 1975

Serial No. 94-28

Printed for the use of the
Committee on Interior and Insular Affairs

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* * *

FINAL JOINT COMMUNIQUE ISSUED BY THE UNITED STATES AND THE MARIANAS POLITICAL STATUS COMMISSION ON DECEMBER 19, 1974

From December 5 through December 19, 1974, the Marianas Political Status Commission and the United States Delegation met for the fifth session of negotiations aimed at achieving the long held desire of the people of the Northern Mariana Islands for political union with the United States of America.

An opening plenary meeting was held on December 5 at which Ambassador F. Haydn Williams, the President's Personal Representative, and Senator Edward DLG Pangelinan, Chairman of the Marianas Political Status Commission spoke about the progress of the negotiations and the issues on the agenda for the fifth session. Following that meeting, working sessions of the commission and the U.S. Delegation were held almost daily. These working meetings were devoted largely to a review of a draft status agreement (to be known as the Covenant) and to a discussion of the terms upon which land needed by the United States for defense purposes would be made available to the United States. The effect of the revised U.S. plans for Tinian was discussed as well. Finally, a number of issues relating to the transition of the Northern Mariana Islands to its new political statue were considered.

Agreement was reached between the United States and the Commission on virtually all issues which have been raised in these negotiations. These agreements are reflected in this Joint Communique and in the attached draft Commonwealth Covenant.

COMMONWEALTH COVENANT

At the conclusion of the fourth session of these negotiations a Joint Drafting Committee was established and charged with the preparation of a draft agreement for the consideration of the principals. The draft produced by the Committee reflected areas of preliminary agreement and areas where further discussion by the principals was required. Discussions during this session of talks have resulted in provisional agreement on the attached draft "Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America".

This agreement is provisional due to the desire of each party to review carefully certain sections of the Covenant before signature. In the case of the United States such review would include further consultations with the United States Congress. The Commission will review the provisional agreement with the Marianas District Legislature and others in the Northern Mariano Islands. Additionally, the attached draft is subject in its entirety to a thorough technical review by both parties. Following signature the Covenant will be formally submitted to the Marianas District Legislature and to the people of the Marianas for their approval and then to the U.S. Congress.

In previous negotiating sessions agreement in principle had been tentatively reached on issues such as the nature of the political relationship between the Northern Marianas and the United States, local self-government, U.S. citizenship or nationality for Marianas residents, United States financial assistance, application of federal laws, taxation, the jurisdiction in the Northern Marianas of United States courts and the extent of U.S. military land require-

ments. During this session those agreements were expanded or modified where necessary and reduced to the language contained in the draft Covenant. In the case of United States military land requirements agreement was reached for the first time on price and method of acquisition. Agreement was also reached on increased levels of direct U.S. financial assistance, in the amounts and for the purposes indicated below.

* * * * *

The United States Delegation wishes to record their sincere appreciation for the warm and gracious hospitality they have once again been accorded by the members of the Marianas Political Status Commission and the people of the Marianas. Both parties wish to express their thanks to the High Commissioner and the Marianas District Administrator, and their respective staffs, and to the Saipan Municipal Council for the support they have provided throughout these talks.

Dated: December 19, 1974

For the Marianas Political Statue Commission:

/s/ Edward DLG Pangelinan
Edward DLG. Pangelinan, Chairman,
Marianas Political Status Commission

/s/ Vincente N. Santos,
Vicente N. Santos, Co-Chairman,
Marianas Political Status Commission

For the United States:

/s/ Franklin Haydn Williams
Franklin Haydn Williams,
The President's Personal
Representative for Micronesian
Status Negotiations

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APPENDIX

DRAFT - December 19, 1974

COVENANT TO ESTABLISH A COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS IN POLITICAL UNION WITH THE UNITED STATES OF AMERICA

Whereas, the Charter of the United Nations and the Trusteeship Agreement between the Security Council of the United Nations and the United States of America guarantee to the people of the Northern Mariana Islands the right freely to express their wishes for self-government or independence; and

Whereas, the United States supports the desire of the people of the Northern Mariana Islands to exercise their inalienable right of self-determination; and

Whereas, the people of the Northern Mariana Islands and the people of the United States share the goals and values found in the American system of government based upon the principles of government by consent, individual freedom and democracy; and

Whereas, for over twenty years, the people of the Northern Mariana Islands, through public petition and referendum, have clearly expressed their desire for political union with the United States;

Now, therefore, the Marianas Political Status Commission, being the duly appointed representative of the people of the Northern Mariana Islands, and the Personal Representative of the President of the United States have entered into this Covenant in order to establish a self-governing commonwealth for the Northern Mariana Islands within the American political system and to define the future relationship between the Northern Mariana Islands and the

United States. This Covenant will be mutually binding when it is approved by the United States, by the Mariana Islands District Legislature and by the people of the Northern Mariana Islands in a plebiscite, constituting on their part a sovereign act of self-determination.

* * * * *

ARTICLE VI

Revenue and Taxation Provisions

Section 601

(a) The income tax laws in force in the United States will be in force in the Northern Mariana Islands as a local territorial income tax in the same manner as those laws are in force in Guam (under the provisions of Section 1421i of title 48, United States Code).

(b) Any individual who is a citizen or a resident of the United States, of Guam or of the Northern Mariana Islands (including a national of the United States who is not a citizen), will file only one income tax return with respect to his income, in a manner similar to the provisions of Section 935 of title 26, United States Code.

(c) References in the Internal Revenue Code to Guam will be deemed also to refer to the Northern Mariana Islands, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof or of this Covenant.

Section 602 The Government of the Northern Mariana Islands may by local law impose such additional taxes as it deems appropriate and provide for the rebate of taxes received by it, but the power of the Government of the Northern Mariana Islands to

rebate collections of the local territorial income tax received by it, will be limited to taxes on income derived from sources within the Northern Mariana Islands.

SUPPLEMENTAL APPENDIX B

48 U.S.C. § 1421i

§ 1421i. Income tax

(a) Applicability of Federal laws; separate tax. The income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in Guam: *Provided*, That notwithstanding any other provision of law, the Legislature of Guam may levy a separate tax on all taxpayers in an amount not to exceed 10 per centum of their annual income tax obligation to the Government of Guam.

(b) Guam Territorial income tax. The income-tax laws in force in Guam pursuant to subsection (a) of this section shall be deemed to impose a separate Territorial income tax, payable to the government of Guam, which tax is designated the "Guam Territorial income tax".

(c) Enforcement of tax. The administration and enforcement of the Guam Territorial income tax shall be performed by or under the supervision of the Governor. Any function needful to the administration and enforcement of the income-tax laws in force in Guam pursuant to subsection (a) of this section shall be performed by any officer or employee of the government of Guam duly authorized by the Governor (either directly, or indirectly by one or more redelegations of authority) to perform such function.

(d) "Income-tax laws" defined; administration and enforcement; rules and regulations.

(1) The income-tax laws in force in Guam pursuant to subsection (a) of this section include but are not limited to the following provisions of the Internal

Revenue Code of 1954 [Internal Revenue Code of 1986], where not manifestly inapplicable or incompatible with the intent of this section: Subtitle A [26 USCS §§ 1 *et seq.*] (not including chapter 2 and section 931 [26 USCS §§ 1401 *et seq.* and 931]); chapters 24 and 25 of subtitle C [26 USCS §§ 3401 *et seq.* and 3501 et seq.], with reference to the collection of income tax at source on wages; and all provisions of subtitle F [26 USCS §§ 6001 et seq.] which apply to the income tax, including provisions as to crimes, other offenses, and forfeitures contained in chapter 75 [26 USCS §§ 7201 *et seq.*]. For the period after 1950 and prior to the effective date of the repeal of any provision of the Internal Revenue Code of 1939 which corresponds to one or more of those provisions of the Internal Revenue Code of 1954 [Internal Revenue Code of 1986] which are included in the income-tax laws in force in Guam pursuant to subsection (a) of this section, such income-tax laws include but are not limited to such provisions of the Internal Revenue Code of 1939.

(2) The Governor or his delegate shall have the same administrative and enforcement powers and remedies with regard to the Guam Territorial income tax as the Secretary of the Treasury, and other United States officials of the executive branch, have with respect to the United States income tax. Needful rules and regulations not inconsistent with the regulations prescribed under section 7654(e) of the Internal Revenue Code of 1954 [1986] [26 USCS § 7654(e)] for enforcement of the Guam Territorial income tax shall be prescribed by the Governor. The Governor or his delegate shall have authority to issue, from time to time, in whole or in part, the text of the income-tax laws in force in Guam pursuant to subsection (a) of this section.

(3) In applying as the Guam Territorial income tax the income-tax laws in force in Guam pursuant to subsection (a) of this section, the rate of tax under sections 871, 881, 884, 1441, 1442, 1443, 1445, and 1446 of the Internal Revenue Code of 1986 [26 USCS §§ 871, 881, 884, 1441, 1442, 1443, 1445, 1446] on any item of income from sources within Guam shall be the same as the rate which would apply with respect to such item were Guam treated as part of the United States for purposes of the treaty obligations of the United States. The preceding sentence shall not apply to determine the rate of tax on any item of income received from a Guam payor if, for any taxable year, the taxes of the Guam payor were rebated under Guam law. For purposes of this subsection, the term "Guam payor" means the person from whom the item of income would be deemed to be received for purposes of claiming treaty benefits were Guam treated as part of the United States.

(e) Substitution of terms. In applying as the Guam Territorial income tax the income-tax laws in force in Guam pursuant to subsection (a) of this section, except where it is manifestly otherwise required, the applicable provisions of the Internal Revenue Codes of 1954 [1986] and 1939, shall be read so as to substitute "Guam" for "United States", "Governor or his delegate" for "Secretary or his delegate", "Governor or his delegate" for "Commissioner of Internal Revenue" and "Collector of Internal Revenue", "District Court of Guam" for "district court" and with other changes in nomenclature and other language, including the omission of inapplicable language, where necessary to effect the intent of this section.

(f) Criminal offenses; prosecution. Any act or failure to act with respect to the Guam Territorial income

tax which constitutes a criminal offense under chapter 75 of subtitle F of the Internal Revenue Code of 1954 [1986] [26 USCS §§ 7201 *et seq.*], or the corresponding provisions of the Internal Revenue Code of 1939, as included in the income-tax laws in force in Guam pursuant to subsection (a) of this section, shall be an offense against the government of Guam and may be prosecuted in the name of the government of Guam by the appropriate officers thereof.

(g) Liens. The government of Guam shall have a lien with respect to the Guam Territorial income tax in the same manner and with the same effect, and subject to the same conditions, as the United States has a lien with respect to the United States income tax. Such lien in respect of the Guam Territorial income tax shall be enforceable in the name of and by the government of Guam. Where filing of a notice of lien is prescribed by the income-tax laws in force in Guam pursuant to subsection (a) of this section, such notice shall be filed in the Office of the Clerk of the District Court of Guam.

(h) Jurisdiction of District Court; suits for recovery or collection of taxes; payment of judgment.

(1) Notwithstanding any provision of section 22 of this Act [48 USCS § 1424] or any other provision of law to the contrary, the District Court of Guam shall have exclusive original jurisdiction over all judicial proceedings in Guam, both criminal and civil, regardless of the degree of the offense or of the amount involved, with respect to the Guam Territorial income tax.

(2) Suits for the recovery of any Guam Territorial income tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to

have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, under the income-tax laws in force in Guam, pursuant to subsection (a) of this section, may, regardless of the amount of claim, be maintained against the government of Guam subject to the same statutory requirements as are applicable to suits for the recovery of such amounts maintained against the United States in the United States district court with respect to the United States income tax. When any judgment against the government of Guam under this paragraph has become final, the Governor shall order the payment of such judgments out of any unencumbered funds in the treasury of Guam.

(3) Execution shall not issue against the Governor or any officer or employee of the government of Guam on a final judgment in any proceeding against him for any acts or for the recovery of money exacted by or paid to him and subsequently paid into the treasury of Guam, in performing his official duties under the income-tax laws in force in Guam pursuant to subsection (a) of this section, if the court certifies that—

(A) probable cause existed; or

(B) such officer or employee acted under the directions of the Governor or his delegate. When such certificate has been issued, the Governor shall order the payment of such judgment out of any unencumbered funds in the treasury of Guam.

(4) A civil action for the collection of the Guam Territorial income tax, together with fines, penalties, and forfeitures or for the recovery of any erroneous refund of such tax, may be brought in the name of and by the government of Guam in the District Court of Guam or in any district court of the United States

or in any court having the jurisdiction of a district court of the United States.

(5) The jurisdiction conferred upon the District Court of Guam by this subsection shall not be subject to transfer to any other court by the legislature, notwithstanding section 22(a) of this Act [48 USCS § 1424(a)].

SUPPLEMENTAL APPENDIX C

GUAM—INCOME TAX

GUAM—INCOME TAX

For text of Act see p. 798

Senate Report No. 2176, Aug. 4, 1958
[To accompany H.R. 12569]

House Report No. 2273, July 24, 1958
[To accompany H.R. 12569]
The Senate Report is set out.

Senate Report No. 2176

THE committee on Interior and Insular Affairs, to whom was referred the bill (H.R. 12569) to amend section 31 of the Organic Act of Guam, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

SUMMARY

Purpose

The purpose of H.R. 12569 is to clarify and restate section 31 of the Organic Act of Guam and to ratify assessments and collections of income taxes that have heretofore been made by the Guamanian authorities under section 31. The bill allows suits against the government of Guam to recover taxes erroneously or illegally collected or assessed. Such suits would be subject to the same statutory requirements as apply in suits against the United States with respect to the United States income tax.

Need

Ever since section 31 was enacted in 1951, the government of Guam has been harassed by litigation

founded principally on the contentions that section 31 gave it no authority to assess and collect these taxes and that, even if it did have this authority, the taxpayers (or most of them) were exempt from payment thereof by section 931 of the Internal Revenue Code of 1954 or section 251 of the 1939 code. Judicial decisions in the United States District Court for the District of Guam and in the Court of Appeals for the Ninth Circuit have sustained the Guamanian government's position, but a number of suits for refund are now pending in the court of claims which, in a recent preliminary ruling in *Jennings v. United States*, has indicated that it may not agree with the ninth circuit. Should the plaintiffs prevail in the Court of Claims and should a judgment in their favor be sustained by the Supreme Court, the revenues of the government of Guam could be reduced by more than $3 million a year, a substantial number of taxpayers would escape payment of all income taxes, and the whole financial structure of Guam would be thrown into confusion. While the committee expects to survey the entire Guamanian tax and financial picture during the next Congress, the present need for H.R. 12569 is obviously urgent.

Cost

Enactment of H.R. 12569 will entail no cost to the United States. However, the bill could save the Treasury an amount of money estimated by the Governor of Guam to be $23 million and estimated by the opponents of the bill to be $8 million.

LEGISLATIVE HISTORY

Departmental recommendation

H.R 12569 was introduced at the request of the Secretary of the Interior made in an executive

communication dated May 1, 1958. It is favored by the legislative and executive branches of the government of Guam. There was also made available to the committee a petition favoring this type of legislation, which petition bears the signatures of more than 5,000 Guamanians

House amendment to section 2

The House of Representatives adopted an amendment of section 2 of H.R. 12569 designed (1) to bring it more closely into line with congressional precedents the constitutionality of which was sustained in *United States v. Heinszen & Co*, (206 U.S. 370, 27 S.Ct. 742, 51 L.Ed. 1098(1907)) and *Rafferty v. Smith, Bell & Co.* (257 U.S. 226, 42 S.Ct. 71, 66 L.Ed. 208 (1921)), and (2) to avoid any possible conflict with the *ex post facto* clause of article I, section 9, of the Constitution by providing that no penalties shall be assessed against any taxpayer for his failure to comply with the income tax laws and regulations of Guam in those circumstances, if any, where it is judicially determined that such compliance could not have been required under section 31 prior to its amendment.

SECTION-BY-SECTION ANALYSIS

Section 1 of the bill is an amendment of section 31 of the Organic Act of Guam. Subsection (a) is a reiteration of the present text of section 31. Subsection (b) declares that the income taxes imposed by virtue of the act shall be deemed to be a territorial income tax. Subsection (c) provides for administration and enforcement of the tax by the Governor of Guam and those to whom he delegates his authority.

Subsection (d) (I) provides that the income-tax laws in force in Guam shall include all provisions of

subtitle A of the Internal Revenue Code of 1954 which are not manifestly inapplicable or incompatible with the intent of section 1 of the bill. To the extent that they are not manifestly inapplicable or incompatible, the income tax laws in force in Guam are declared to include all provisions of law relating to the withholding of income tax which are set forth in chapters 24 and 25 of subtitle C of the 1954 code and all provisions of law relating to administration of the income tax (including income tax withholding) which are set forth in subtitle F of the 1954 code. The corresponding provisions of the 1939 code are also included in the income-tax laws in force in Guam for the appropriate period, that is, from the time when the provisions of present section 31 of the Organic Act of Guam became operative until the effective date of those provisions of the 1954 code which are included in the income-tax laws in force in Guam.

On the other hand, chapter 2 and section 931, both in subtitle A of the 1954 Code, and their predecessor provisions of the 1939 Code are specifically indicated as not constituting a part of the income-tax laws in force in Guam. Chapter 2 provides for a tax on self-employment income. Section 931 provides an exclusion from gross income in respect of income derived from sources outside the United States and received outside the United States by certain citizens of the United States deriving at least 80 percent of their income (not including Federal salaries) during a prescribed period from sources within a possession, including Guam, and at least 50 percent of their income from the active conduct of a trade or business (including the performance of services as an employee) in a possession, including Guam. Since it is made clear that section 931 and the corresponding provisions of prior law are not a part of the income-tax laws in

force in Guam, taxpayers will not be able to try to claim the exclusions provided in those sections in determining their income-tax liability to Guam. For example, a construction worker whose entire income for 1951 consisted of wages earned and received in Guam will not be entitled to exclude any part of that income from the computation of the income tax which be owed to Guam for that year, even though he was engaged in a trade or business there within the meaning of section 251 of the 1939 Internal Revenue Code and his income for the prescribed period met the percentage requirements stated in that section. On the contrary, all such income constitutes gross income reportable to the government of Guam. This is the effect obtained under subsection (d) (1); it is also the effect obtained under existing law as understood by the committee in the light of the legislative history of present section 31 of the Organic Act of Guam. Thus, in this respect as well as otherwise, the provisions of subsection (d) (1) are merely in confirmation of present law and of the original congressional intent in enacting section 31 of the Organic Act of Guam.

The specific mention of chapter 2 and section 931 of the 1954 code and of corresponding provisions of the 1939 code from the income-tax laws in force in Guam is not intended to exclude other provisions of the 1954 or 1939 codes from the category of provisions which are manifestly inapplicable or incompatible with the intent of Congress in making the income-tax laws of the United States applicable in Guam. Other provisions of the 1954 and 1939 codes which are manifestly inapplicable or incompatible with that intent (for instance, section 932 of the 1954 code and section 252 of the 1939 code) are also excluded even though not specifically singled out for mention.

Subsection (d) (2) and subsection (e) are complementary to subsection (c) and set up the mechanics of administering and enforcing the income-tax laws in Guam. Subsection (f) deals with the prosecution of criminal offenses and subsection (g) with liens. Subsection (h) gives the District Court of Guam exclusive original jurisdiction over suits and prosecutions in Guam involving the Territorial income tax. It also provides the means of recovery of taxes wrongfully assessed or collected by the government of Guam and for civil actions by it to collect its taxes.

Section 2 of the bill declares that subsections (b) to (g), inclusive, of section 1 express the true meaning and intent of section 31 as it has heretofore existed. Section 2 also ratifies the income taxes assessed and collected under section 31 and all acts done to effectuate their assessment and collection insofar as these are in accord with the amended section 31. Provision is made, however, that no penalties shall be imposed for failure to have complied with a requirement if it is judicially determined that, in the circumstances, that requirement could not lawfully have been made under the original section 31. This will not excuse failure to comply after 60 days from enactment of the bill.

EXECUTIVE COMMUNICATION

The executive communication of the Department of the Interior is set forth below in full:

Committee recommendation

The Committee on Interior and Insular Affairs recommends enactment of H.R. 12569, as amended.

DEPARTMENT OF THE INTERIOR,
OFFICE OF THE SECRETARY,
Washington, D.C., May 1, 1958.

Hon. SAM RAYBURN,

Speaker of the House of Representatives,
Washington, D C.

DEAR MR. SPEAKER: Enclosed herewith is a draft of a proposed bill, to amend section 31 of the Organic Act of Guam, and for other purposes.

I suggest that the proposed bill be referred to the appropriate committee for consideration, and I recommend that it be enacted.

The purpose of the proposed bill is to continue the present separate territorial income tax for the territory of Guam, as provided by section 31 of the Organic Act of Guam (48 U.S.C., sec. 1421i), but to add various clarifying provisions and, in addition, to give taxpayers who are subject to the tax certain remedies equivalent to those available under the United States income-tax laws.

Amendments which are contained in the proposed new subsections (a) through (g) of section 31 are for the purpose of clarification. They expressly provide, among other things, that the separate Guam income tax is to continue to be enforced by the Governor of Guam and officials of the Territorial government under him, and that these officials have available to them the enforcement powers as set forth in the Internal Revenue Code. The provisions in subsection (a) through (g) of section 31 accord with numerous judicial and administrative decisions, all of which are cited in an explanatory note attached hereto. We are aware of only one decision contrary to the holdings in the cited cases, namely, the recent decision of the Court of Claims on a preliminary motion in *Jennings et al. v. United States*. In denying the United States motion to dismiss the plaintiffs' petitions in that case,

the Court of Claims indicated the view that section 31 did not create a separate Territorial income tax. Although the Government of Guam is continuing to adhere to the long line of decisions to the contrary, the court of claims action has created considerable confusion in Guam and consequently enactment of the proposed bill has become urgent

Under the proposed subsection (h), taxpayers are given the right to contest their tax liability by suing the Government of Guam directly in the District Court of Guam for a refund of taxes collected. At present the only remedy available to a taxpayer in Guam is to sue the tax-collecting official of the Government of Guam.

A more detailed explanation of the proposed bill is enclosed herewith.

The Bureau of the Budget has advised that there is no objection to the presentation of this proposed legislation to the Congress.

Sincerely yours,

ROGER ERNST,

Assistant Secretary of the Interior.

EXPLANATORY NOTE TO ACCOMPANY BILL TO AMEND SECTION 31 OF THE ORGANIC ACT OF GUAM

Section 31 of the Organic Act of Guam (64 Stat. 384, 392, 48 U.S.C., sec. 1421i) reads as follows:

"The income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in Guam"

This section has been held to provide a separate Territorial tax to be enforced by the Government of

Guam, comparable to the income tax of the Virgin Islands enacted by the act of July 12, 1921 (47 Stat. 122, 123; 48 U.S.C, sec. 1397)

Laguana v. Ansell (D.C.Guam, 1952) 102 F. Supp. 919, *aff'd* (C.A. 9, 1954) 212 F.2d 207, *certiorari denied* 348 U.S. 830, 75 S.Ct. 51, 99 L.Ed. 654.

Wilson v. Kennedy (D.C.Guam, 1954) 123 F. Supp. 156 *aff'd* (C.A. 9, 1956) 232 F.2d 153.

Lamkin v. Brown and Root (C.A. 9, 1956) 233 F.2d 320.

Phelan v. Taitano (C.A. 9, 1956) 233 F.2d 117.

Holbrook v. Taitano (D.C.Guam, 1954) 125 F. Supp. 14.

Government of Guam v. Kaanehe (D.C.Guam, Appellate Division, 1956) 137 F.Supp. 189.

I.T. 4046 (1951-1 Cum.Bull. 57).

I.T. 2946 (Cum.Bull. X14-2, 109 (1935) (concerns Virgin Islands tax).

Rev.Rul. 8, 1953-1 Cum.Bull. 300, 301,

Rev.Rul. 56, 1953-1 Cum.Bull. 303.

Rev.Rul, 55-184, 1955-13 Int.Rev.Bull. 39, 1955-47 Int.Rev.Bull. 18.

Decision of the Comptroller General, B-126996, May 4, 1956.

The purpose of this bill to amend section 31 is to continue the tax provided by section 31 but to add clarification in accordance with the interpretations in the foregoing rulings and court decisions, and to authorize suits for refunds against the government of Guam.

Subsection (a)

The present section 31 is designated subsection (a) of the amended section.

Subsection (b)

Subsection (b) sets forth the basic interpretation of the present section 31 as presently enforced and as set forth in *Laguana v. Ansell* which in turn followed I.T. 4046 and I.T. 2946, the latter being with reference to the Virgin Islands tax. The last portion of the subsection designates a name for the separate tax for convenient reference.

Subsection (c)

Subsection (c) expressly designates the Governor of Guam as the official to enforce the tax. This authority he may delegate, including authority to redelegate. *Laguana v. Ansell* holds that the separate territorial tax is "to be collected by the proper officials of the Government of Guam." The present authority of other officials, under the Governor, is recognized in *Wilson v. Kennedy*.

The language is based on sections 7801 (a) and 7701 (a) (12) of the Internal Revenue Code of 1954.

Subsection (d) (1)

Paragraph (1) of subsection (d) defines "income-tax laws" mentioned in subparagraph (a) by referring to subtitles A, C, and P of the Internal Revenue Code of 1954, and the corresponding provisions of the Internal Revenue Code of 1939. An unconditional incorporation by reference not possible since various provisions refer to other taxes than income taxes, and the nomenclature throughout is with regard to the United States tax. Moreover certain provisions must be considered inapplicable in order to carry out the

intent of the separate tax. Thus in *Laguana v. Ansell*, supra, the court held that sections 251, 252, and 1621(a) (8)(B) of the 1939 code, dealing with exemptions for income earned in a possession of the United States, did not apply to the Territorial tax, although literally the plaintiff came within the provisions. In disposing of a preliminary motion in (*Jennings et al. v. United States*), the Court of Claims suggested otherwise with respect to section 931 of the 1954 Code (the successor to section 251), and this point is taken into account in subsection (d) (1) by the specific exclusion of section 931 from the Guam Territorial income tax.

Special reference is made to criminal provisions in view of their unique character in law. In *Government of Guam v. Kaanehe* they have been held to be incorporated by reference.

Reference to the Internal Revenue Code of 1939 is necessary in this paragraph and elsewhere in the bill, since it was in effect when the separate tax under section 31 went into effect on January 1, 1951, and constitutes the income-tax laws for the period prior to the effectiveness of the code of 1954.

The use of such qualifying terms as "where not manifestly inapplicable or incompatible"; "include but are not limited to"; "which correspond to one or more of those provisions", "applicable provisions"; and "corresponding provisions", in this paragraph and elsewhere in the bill is an obvious necessity and is similar to language used in the Internal Revenue Code of 1954. Thus:

> "Manifestly incompatibles": Sections 7701(c), 7851(b) (3), 78511 (b) (2) (C), 7852(b).

"All provisions * * * applicable to the administration, collection and enforcement": Sections 7651(1), 7651(2) (B).

"Corresponding provision: Sections 7851(e), 7852(b), 7807(b) (1) and (2).

Subsection (d) (2)

Paragraph (2) of subsection (d) des in with the reference, in paragraph (1) of subsection (d), to subtitle F, the enforcement provisions of the Internal Revenue Code of 1954. Paragraph (2) expressly indicates the intent that the Governor or his delegate has the same enforcement powers as United States tax officials. This is in accordance with the decision in *Wilson v. Kennedy*.

Paragraph (2) also authorizes the issuance of regulations by the Governor, in connection with the Guam Territorial income tax, and authorizes the Governor or his delegate to publish the text of the tax from time to time in whole or in part. He is thus authorized to adapt in written version the income-tax laws of the United States as the Guam Territorial income tax in accordance with the intent and under the terms of section 31.

The publication of such a text by the Governor is not intended to bc a prerequisite or condition to tax liability but only to afford a convenience to taxpayers.

Subsection (e)

Subsection (e) authorizes the substitution of nomenclature and other changes in language in applying the income-tax laws of the United States as the Guam Territorial income tax. This is an obvious necessity, and is in accord with *Wilson v. Kennedy* (I.T. 4046, and I.T. 2946).

Subsection (f)

Subsection (f) makes clear that the incorporation of the criminal provisions of the Internal Revenue Codes establishes offenses against the government of Guam to be prosecuted by officials of the government of Guam.

Subsection (g)

Subsection (g) makes clear that the tax lien provisions of the Internal Revenue Code apply in favor of the Government of Guam, and that notices of lien are to be filed with the clerk of the District Court of Guam.

The term "in the same manner and with the same effect" is used in section 7851(c) of the Internal Revenue Code of 1954.

Subsection (h) (1)

Paragraph (1) of subsection (h) gives the District Court of Guam exclusive original jurisdiction over all litigation in Guam concerning the Guam Territorial income tax, both civil and criminal. Jurisdiction of district courts elsewhere is covered in paragraph (4). At the present time the Island Court of Guam, a court created by the Guam Legislature, has jurisdiction over misdemeanors and suits involving sums up to $2,000. The purpose of this paragraph is to insure that jurisdiction as to all cases involving the Guam Territorial income tax shall be in the district court.

The language is suggested by title 28, United States Code, section 1340, with the additional of criminal jurisdiction.

Subsection (h) (2)

Paragraph (2) of subsection (h) provides that the Government of Guam may be sued for refund of taxes

and for payment of any final judgment in such litigation. At the present time it is probable that the Government would be held immune. *Crain v. Government of Guam* (195 F.2d 414). As a result the only remedy of the taxpayer is to sue the collecting official personally for refund, as was done in *Laguana v. Ansell* and *Wilson v. Kennedy*.

The language is based on title 28, United States Code, sections 1346(a) (1) and 2006, and section 7422(a) of the Internal Revenue Code of 1954.

Subsection (h) (3)

Paragraph (3) of subsection (h) precludes execution against an officer or employee of the Government of Guam against whom a judgment is obtained in a personal suit for a tax refund or for other acts in connection with enforcement of the Guam Territorial income tax. Instead, provision is made for payment of the judgment by the Government of Guam.

The language is based on title 28, United States Code, section 2006.

Subsection (h) (4)

Paragraph (4) of subsection (h) enables the Government of Guam to bring suit in any district court, constitutional or legislative, for collection of the Guam Territorial income tax or recovery of excessive refunds against tax delinquents who have left Guam. This will eliminate any problem of whether a State court may have jurisdiction over tax cases of another political entity.

Subsection (h) (5)

Paragraph (5) of subsection (h) precludes the Guam Legislature from divesting the District Court of

Guam of its jurisdiction over the Guam Territorial income tax.

Section 2

Section 2 of the bill provides an effective date for the provisions contained in section 1 and ratifies and confirms the authority of the Governor and officials and employees of the Government of Guam since January 1, 1951, the date the separate tax originally went into effect.

REAL ACTIONS--LIS PENDENS--RECORDATION

For text of Act see p. 801

Senate Report No. 2131, Aug. 4, 1958
[To accompany H.R. 7306]

House Report No. 1719, May 13, 1958
[To accompany H.R. 7306]

The Senate Report is set out.

Senate Report No. 2131

The Committee on the Judiciary, to which was referred the bill (H.R. 7306) to amend title 28 of the United States Code to provide that notice of an action with respect to real property pending before a United States district court must be recorded in certain instances in order to provide constructive notice of such action, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

PURPOSE

The purpose of the proposed legislation is to provide that notice of an action (usually referred to as lis pendens) with respect to real property, pending before a United States district court, must be recorded; if the State law so provides, in order to be considered

constructive notice to others that such action is pending.

STATEMENT

The report of the Administrative Office of the United States Courts states that the Judicial Conference of the United States has considered and approved this legislation. The Department of Justice states that it would have no objection to the enactment of the bill, and the Department of the Interior in its report likewise states that that Department would have no objection to the enactment of the bill.

The justifications for this legislation appear in House Report No. 1719 on H.R. 7306, and are as follows:

> Present Federal law (28 U.S.C. 1962), makes provision for the recording of Federal judgments as liens on real property. This bill would make a substantially similar provision with respect to notice of the institution of suits (lis pendens) in the Federal district courts concerning real property.
>
> The Committee on Revision of the Laws of the Judicial Conference of the United States considered this legislation and feels that it would make a very definite and needed improvement in the law, and the Judicial Conference, at its September meeting (1957) approved the legislation in principle. Thereafter the Honorable Albert B. Marie, circuit judge, appeared before Subcommittee No. 3 of the House Committee on the Judiciary on behalf of the Judicial Conference and testified in favor of the instant bill.
>
> The legislation contains two requirements: (1) the State law must require that notice of local

suits in State courts (as distinguished front Federal courts) be registered, recorded, docketed, or indexed; and (2) the State law must also expressly authorize notice of Federal suits to be registered, indexed, etc., in the same manner as notices in State courts. These provisions, of course, will require future legislative action on the part of the individual State legislatures and they will not become effective within a State until it has expressly authorized such registering, recording, etc. This latter provision is necessary since Congress cannot properly seek to impose on State officers such as clerks of courts or registrars of conveyances, the duty of recording or indexing of Federal notices unless the States open the way and are willing to have their officers receive such papers.

In order that Federal litigants may obtain the same protection as is offered in State court actions, the bill provides that the State law authorizing the registering, etc., of Federal notices must be the same as that for registering of State notices in State court actions with respect to real property.

In many States real property can be situated great distances from the Federal courts and interested persons are oftentimes unaware that a suit way be pending therein affecting the property. This gives rise to the unfortunate situation of a plaintiff asserting a right against the property and, while the suit is pending, the property being sold to a third party, thereby rendering unenforceable whatever rights the plaintiff may later be adjudged to have against the property. In order to avoid such events and to insure the

proper enforcement of the orders of the courts, the instant bill provides for constructive notice so that all who seek either to buy the property or to secure its possession, or even to place a lien upon it, do so with notice of and subject to whatever rights the prior institution of the Federal action may have upon the property.